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ABSTRACT

A study examined the issue of contracting out traditional government services and its effect on government employees. It found that local governments contract out for two principal reasons: to cut the cost of providing services and to employ specialized skills and resources unavailable within the government. Findings from a review of the privatization literature were that: (1) only about 5-10 percent of public employees affected by contracting out were laid off; (2) public assistance payments to laid-off workers were very low; (3) private contractors paid lower wages and offered lower fringe benefits; (4) contracting out was not inherently harmful to minorities or women; and (5) contracting may have a slightly positive impact on the number of available jobs. Interviews with local officials from 17 cities and counties generally confirmed these findings and indicated that very few workers were laid off as a result of contracting out and few cities had formal contracting out employment policies. Policy recommendations were as follows: (1) target new and expanded services for contracting out; (2) establish a "no layoff" policy; (3) reduce the government work force through attrition; (4) encourage government employees to form private companies to provide government services; (5) allow the city agency to compete in the bidding process; and (6) develop policies for aiding displaced public employees. (66 references) (YLB)

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Privatization and Public Employees:

The Impact of City and County Contracting Out on Government Workers

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National Commission for Employment Policy

May 1988

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Privatization and Public Employees:

The Impact of City and County Contracting Out on Government Workers

A Study Prepared by Dudek & Company
for the National Commission for Employment Policy

May 1988 RR-88-07

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EXECUTIVE SUMMARY

■ The contracting out of traditional government services is a popular form of privatization that is growing at a remarkable pace in cities and counties throughout the United States. The total dollar amount of local government contracts has more than tripled since 1972. Most studies project this rate of increase to continue through at least the year 2000.

When a government contracts out an activity it retains its funding responsibility but hires a private firm to perform or deliver the service. Traditionally, contracting out has involved such routine commercial activities as garbage collection, data processing, janitorial services, and park maintenance. But recent surveys indicate that local jurisdictions are increasingly turning to the private sector to perform a much wider range of activities, including fire fighting, ambulance service, air traffic control operations, jail and other correctional responsibilities and even the city management function itself. The newest trend of all on the public policy frontier involves the contracting out of human services: day care, public health centers, drug rehabilitation, and legal services for the poor.

Local governments contract out for two principal reasons. The overriding motivation for contracting out is to cut the cost of providing government services. Numerous studies have established that by contracting out cities and counties typically have slashed the cost of municipal services between 20 percent and 50 percent. The second motivation for turning to the private sector to deliver government services is to employ specialized skills and resources that may be unavailable within the government. This is particularly important in the delivery of human services where the best professional work force may be in the private sector and where private nonprofit organizations have in many cases already developed the capacity to deliver newly government-funded services.

The largest current impediment to contracting out is the concern that as private firms begin to perform government functions, public sector workers will lose their jobs or will suffer reduced wage rates. Public employee unions have vehemently resisted local contracting out initiatives. In many cases their opposition—through such methods as lobbying campaigns and lawsuits—has succeeded in blocking proposals to move city services into the private sector. Several studies have found that contracting out is least common in cities and regions where public employee unions are the strongest. The implication of this successful union opposition to contracting out is clear: until government officials adopt

an employee treatment strategy that eases the fears and concerns of the public sector workforce, opportunities for contracting out will be constrained. This is especially true on the federal level, where over one-half million positions have been identified as candidates for contracting out, but where there has been almost no progress in moving these functions into the private sector over the last decade.

This study examines from three directions the issue of contracting out and its effect on government employees. First, we extensively reviewed the literature on contracting out and report research findings on the issue of employment effects of contracting out. Next, we interviewed officials from seventeen cities and counties to determine their experiences with contracting out, the employee treatment strategies they have developed, and the success of those policies. Finally, we make policy recommendations for government officials who wish to promote contracting out while minimizing the impact on public workers.

Findings from The Privatization Literature

■ We examined the literature on contracting out with respect to seven employment-related policy questions:

1) What percentage of workers lose their jobs as a result of contracting out?

2) How much public assistance do government workers displaced as a result of contracting out receive?

3) Do private contractors pay lower wages than government agencies for the same types of work?

4) How do fringe benefits offered by private contractors compare with benefits offered by local governments?

5) Do private contractors use labor more efficiently than the public sector?

6) What effect does contracting out have on minorities and women?

7) What is the overall employment effect of contracting out when taking into consideration the job opportunities created in the private sector?

Our findings, in brief, for each of these issues were as follows:

1) On average, only about 5 percent to 10 percent of public employees affected by government contracting out are laid off as a result of this alternative delivery approach. Unfortunately, there is little data available as to the subsequent labor market experience of workers laid off by the government due to contracting out.

2) Public assistance payments paid to laid off public workers have been very low in the past—amounting to only 0.5 percent of the savings generated from contracting out, according to one study.

3) Private contractors generally pay lower wages than do the government agencies they replace. This wage disparity, however, varies widely

among services. For some services, wages of private contractor workers were about half the wages of the government workers. However, for other services the private sector pay levels exceeded the levels within the government.

4) The largest difference between the government and the private contractor is in the level of fringe benefits provided. The government usually provides much more generous fringe benefits than do contractors, with the biggest disparity being in retirement benefits.

5) Increasing labor productivity is one of the primary ways that private sector contractors reduce their costs below those of in-house government providers. For instance, private firms contracting with the government generally make greater use of incentive pay systems, enjoy greater flexibility in hiring and firing workers, are more dependent upon part-time workers, have lower rates of absenteeism, and hire more multi-skilled workers.

6) Contracting out is not inherently harmful to minorities or women. Although blacks are more likely to be employed by the government than whites, the evidence indicates that contractors hire minorities in about the same percentage that the government hires minorities. Overall employment opportunities for minorities are therefore not reduced by privatization. Blacks are harmed by contracting out only to the extent that the total compensation package is higher within government than within the private sector. Contracting out does not affect women disproportionately, because the vast majority of females in the government workforce are in white collar jobs, whereas the vast majority of government positions contracted out are blue collar jobs.

7) Economic theory predicts that reducing the cost of government services through contracting out will create at least as many direct and indirect employment opportunities in the private sector as will be eliminated in the public sector. Only one study has examined scientifically the secondary job market effects of contracting out. It found that, overall, about an equal number of jobs were created by contracting out as were lost, though the jobs generated might be located in different occupations and different regions of the country than the local public sector jobs terminated.

We believe that more research on the impact of contracting out on employment opportunities is sorely needed in two areas. First, there needs to be a longitudinal study of the typical employment experience of former public employees one year, two years, and as many as five years after their positions are contracted out. The glaring weakness of the current literature is that most studies only examine the employment consequences of contracting out immediately after the conversion to private contract occurs. This ignores the vitally important long term job impact. Second, a more detailed study needs to be performed of the secondary employment implications of contracting out to determine more definitively whether the workforce as a whole suffers or benefits from this form of privatization.

Employment Policies of Cities and Counties

■ We interviewed public officials involved in the contracting out process from seventeen U.S. cities and counties to determine the extent to which contracting out adversely impacted government workers. We also sought to discover what types of employment policies these cities adopted to minimize public employee union opposition to competitive contracting. This was not a random selection of jurisdictions; rather, we selected those cities and counties with either very large or unique contracting out programs. Our examination yielded the following conclusions:

1) Government workers were almost always initially hostile to new contracting out initiatives. Whether this hostility would ultimately block the government effort to contract out the service in question often depended upon the job protection guarantees afforded to the affected work force.

2) Very few workers were laid off as a result of contracting out. In only two of seventeen jurisdictions did the government lay off workers without assuring them some alternative job opportunity. In most cases the government agency either transferred affected workers to other government jobs, or required the contractor to hire the government workers.

3) Most cities have not established formal contracting out employment policies but rather resolve the employment questions on an ad hoc basis.

4) Cities that had adopted accommodating employment policies for government workers in the past tended to confront the least amount of resistance in their contracting out efforts. These also tended to be the cities with the most active contracting out programs. This confirmed our belief that formulating a contracting out policy that addresses the fears of the government workforce is a vital element to a successful program.

5) Most cities contract out for new and expanding services. The benefit of contracting out these activities is that no existing government employees are affected by the contract.

6) Reducing the government workforce through attrition—as opposed to lay-offs—is a common contracting out employment policy of these cities. However, for cities with very aggressive contracting out programs, a policy of reducing the government workforce through attrition may delay program savings and impede further contracting out efforts as affected workers are transferred to other government jobs that are also candidates for contracting out. This is currently a vexing problem for Los Angeles County, California whose contracting out program is so extensive the attrition rate is too slow to bring about real reductions in operating budgets.

7) In contrast to the research findings that we reported from the literature, wages of contractors in these seventeen cities were, on average, higher than, or equal to, the wages paid by the in-house government agency. Fringe benefits, on the other hand were generally lower in the private sector, confirming the earlier finding from our survey of the liter-

ature. Less generous fringe benefits were thought to be an important source of cost savings by the officials we interviewed.

8) Worker productivity, where measurable, tended to be higher for private contractor workers than for government workers. This higher productivity was also considered by these government officials to be a source of cost savings.

9) Government workers who took jobs with contractors rarely stayed with the contractor for more than two years. In many cases the workers shifted back into the public sector workforce after their short stint in the private sector.

10) In cases where the government agency openly competed with the private vendor for government contracts, public sector productivity improved and union resistance to contracting out tended to decline slightly. Allowing the government to compete side-by-side against the contractor was a standard policy of two pioneering cities in contracting out: Phoenix, Arizona and Newark, New Jersey.

Section V of this report presents a range of policy recommendations for developing contracting out employment policies. These recommendations are based upon our observations of successful policies adopted by the cities and counties contained in our survey.

Our foremost recommendation is that cities and counties avoid laying off workers as a result of contracting out. Worker lay-offs almost always generate intense hostility toward the concept of privatization and close off avenues for future contracting out. In short, laying off workers is bad politics and bad public relations. Reducing the workforce through attrition or requiring government contractors to offer affected government workers the right of first refusal to the jobs they have available are more prudent strategies.

SECTION I

Privatization Efforts in the Nation's Cities and Counties: A Brief Overview

■ Over the last ten years U.S. cities and counties have grown increasingly reliant on the private sector to deliver goods and services traditionally provided directly by government. This phenomenon has become popularly known as "privatization."

In the broadest sense, privatization refers to the attainment of any public policy goal through the participation of the private sector. For instance, government voucher programs in such areas as housing, education, and health care are an increasingly popular form of privatization. Under the voucher concept, recipients of a government service are permitted to "shop around" in the private sector to find a provider of the service rather than having to deal exclusively with a monopoly government service deliverer.

Another method of privatization is asset divestiture, where the public sector sells an asset, such as government land holdings, to the private sector to generate revenue and/or to spur private sector development. This is the most common form of privatization in foreign countries. In Great Britain, for example, over $30 billion worth of government assets have been sold to the private sector. In the United States this form of privatization is still unusual, though one notable recent case of government asset divestiture was the sale of the federally owned railroad, Conrail, for $1.9 billion through a public stock offering in 1987. In addition, over $4 billion worth of federal loans are scheduled to be sold to private investment banks in 1987.

Another form of privatization is private ownership and operation of facilities that provide public services. A prominent example of this type of privatization is the private ownership of municipal wastewater treatment plants, which clean and treat sewage before it is dumped into streams and rivers. The private owners charge the city a fixed fee for the service they provide. Privately constructed, owned, and operated transit facilities, though in the infancy stage, are also becoming more common in small and medium-sized U.S. cities. A survey of over 1,000 U.S. cities by Touche Ross (1987) found that about 30 percent had privatized facilities in the last five years. The principal advantage of this privatization approach is that it frees up government funds for other expenditure requirements.

At the state and local level, however, by far the most widely-used form of privatization is contracting out. Touche Ross (1987) found that 99 percent of U.S. cities contract out at least some services. When a public agency contracts out a government activity, it retains its funding responsibility, but hires a private vendor to perform the service. The private provider is normally a for-profit company when the service contracted is a routine commercial activity, such as vehicle towing or garbage collection. If the activity is a human service, such as day care, then the private provider in most cases is a not-for-profit vendor. Typically, contracts are awarded through a competitive bidding process, which allows the local government to obtain the service at the lowest possible cost.

Contracting out appears to be the one form of privatization where employment-related issues are a major concern to the government workforce and public officials. For example, the 1987 Touche Ross survey asked local administrators: "What are the impediments to privatization in your government?" The percent of respondents listing "Union or Employee Resistance" for the three most common forms of privatization was as follows:

Percent of Public Managers Listing Employee Resistance as an Impediment to Privatization

Contracting Services Out	47%
Privatizing Facilities	15%
Asset Sales	16%

The authors of the Touche Ross report interpreted this finding of low levels of employee opposition to asset sales and privatization of facilities by

noting: "Fewer employees are involved in these kinds of privatization than in contracting services out, or perhaps employees have more assurance that they can keep their jobs when these kinds of privatization are undertaken."

For whatever reason, the contracting out option is clearly the form of privatization with the most direct and controversial impact on employment, and thus it will serve as the focus of this report.

Trends in State and Local Contracting Out

■ Both the number and size of municipal government contracts with private and not-for-profit firms have mushroomed in recent years. Between 1972 and 1982, for instance, the total dollar amount of local government contract awards with private firms about tripled from $22 billion to $65 billion.[1] And every indication is that this number has continued to rise since 1982.

The list of services that cities are opening up to private sector competition is continually lengthening. The municipal contracting out revolution now involves such wide-ranging services as data processing, fire fighting, golf course operations, local air traffic control, and even the city management function itself. Table 1 shows the percentage of cities that were contracting out a wide range of services in 1987. The annual rate of growth in contracting out over the last ten years has been estimated to be as high as 16 percent (Savas, 1987).

The prospects for future local privatization efforts also appear quite promising. Toucne Ross's survey of city officials found that "nearly 80 percent of the respondents believe privatization will represent a primary tool to provide local government services and facilities in the next decade."

An area where the outlook for privatization appears particularly bright is in private ownership of public service facilities. Ted David, privatization director for Touche Ross and Company, one of the nation's largest accounting firms, calculates that by the year 2000 government contracts with the private sector may exceed $3 trillion in the area of infrastructure improvement alone (Tapscott, 1986). Although the financial health of most U.S. municipalities has improved markedly during the 1980s, cities almost certainly will not be capable of raising the tens of billions of dollars of capital that will be needed for the rehabilitation of such facilities as transit systems, wastewater treatment plants, hospitals, roads, bridges, and airports. Creative financing techniques available through privatization are therefore expected to become an increasingly attractive option.

TABLE 1

Cities and Counties Contracting Out Selected Municipal Services 1987

Service	Percentage of All Cities/Counties Contracting Each Service
Corrections	7%
Crime Patrol	7%
Data Processing	31%
Hospitals	16%
Legal Services	36%
Payroll	36%
Recreational Facilities	19%
Refuse Collection	59%
Solid Waste Disposal	59%
Street Repair	29%
Traffic Signal Maintenance	32%
Transit Services	17%
Utility Billing	11%
Vehicle Maintenance	21%
Vehicle Towing	45%

Source: Touche Ross & Co., "Privatization in America: An Opinion Survey of City and County Governments on Their Use of Privatization and Their Infrastructure Needs," 1987.

Contracting Out Social Services

■ The contracting out phenomenon has been spreading in recent years to the delivery of social services. Day care, hospitalization, drug treatment and prevention programs, and legal aid for the poor, are the types of human services that are just beginning to be delivered by private rather than government entities. For example, public services are now commonly provided by churches, neighborhood associations, and other voluntary community groups, which are more capable than

[1] 1982 is the most recent year for which we could find reliable estimates of the dollar amount of city and county contracts with private firms.

government welfare agencies of targeting service benefits to those most in need. In 1983, over $1 billion in local public services were provided by such voluntary nonprofit groups.

Contracting out social services is most common in the state of California. Ralph M. Kramer and Paul Terrell, of the University of California at Berkeley, surveyed 57 welfare agencies in the San Francisco Bay Area in 1984 and found that over 70 percent contract out at least one social service. The authors summarized their findings in this way: "Contracting today is far more than an anomaly on the periphery of the welfare state; it is a core feature of ground-level social welfare administration in many service areas. . . . In short, the mingling of public and private funds and functions pervades the welfare state."

Contracting of human services is becoming increasingly prevalent on the state level. This is because the states are the primary source of funding for welfare and health services, such as Medicaid.

Why Local Governments Contract Out

■ The primary motivation for contracting out government services is to save money. In the previously cited survey of cities by Touche Ross (1987) 74 percent of local officials listed cost savings as a major advantage of contracting services. And 80 percent of the respondents indicated that contracting out had cut the taxpayers' cost of government services by at least 10 percent.

It is no accident that the rapid adoption of contracting out as an acceptable government management technique coincided with a period of unparalleled financial strain for America's urban areas. During the late 1970s and early 1980s, several factors combined to cause a deterioration in the fiscal conditions of cities: taxpayer revolts, such as California's Proposition 13, which depleted local governments of tax revenues; reductions in federal aid payments; and two deep economic recessions. These combined forces led to a heightened demand for services coinciding with unexpectedly slow growth in government revenues in most jurisdictions. Teal (1984) found that cities suffering the largest reductions in state and federal aid were the most prone to turn to competitive contracting.

The cost-cutting potential from contracting out city services has been well-documented. At least a dozen studies have discovered that competitive contracting cuts the cost to the government by an average of 20 to 30 percent, with the extent of cost

TABLE 2

Cost Savings From Contracting Out City Services

Author of Study	Service Type	Savings from Contracting
Stevens	Asphalt Overlay Construction	**96%**
Stevens	Janitorial	**73%**
Stevens	Payroll	**no savings**
Stevens	Refuse Collection	**28–42%**
Stevens	Street Cleaning	**43%**
Stevens	Street Tree Maintenance	**37%**
Stevens	Traffic Signal Maintenance	**56%**
Stevens	Turf Maintenance	**40%**
Savas	Solid Waste	**37%**
Teal	Mass Transit Services	**35–50%**
Hanke	Wastewater Treatment Operations	**20–50%**
Morlok and Moseley	Bus Service	**20–25%**
Whitman	Street Maintenance	**16%**
Ahlbrandt	Fire Fighting Services	**47%**

savings depending upon the type of service.[2]

The most comprehensive study to compare the cost of "in-house" city service provision with the cost of contracting out was conducted by Stevens (1984) for the U.S. Department of Housing and Urban Development. Stevens compared the costs of eight services in ten cities that had a competitive contracting arrangement versus ten cities that depended exclusively on the "in-house" municipal agency to perform the service. All of the cities in the study were located in Los Angeles County, California. The percentage cost savings found by Stevens as well as similar cost studies examining other services are summarized in Table 2.

These cost savings for contracted services probably underestimate the economic advantage of contracting out. They do not take into account, for instance, that private firms pay a variety of taxes and user charges that the tax-exempt government agency does not. These taxes collected from private firms make funds available for expanded services elsewhere. Morlok and Moseley (1986) have calculated that if the public agency were to compete on an equal accounting basis with the private contractor by being required to make such payments as income taxes, property taxes, and excise taxes, the government's cost of providing transit services would be about 9 percent higher than the agency's stated costs.

Even in the area of social services—which unlike routine commercial municipal services, are not primarily contracted out to cut costs, but rather to improve the quality and reliability of service provision—impressive budget savings have been recorded. Schultz, Greenley, and Petersen (1984), for instance, found private production to have reduced city expenses for hospital care and mental health services.

The budgetary savings from contracting out on the city and county level have been generally duplicated by the federal government. Though political factors have inhibited widespread federal reliance on private firms to deliver most of the over 11,000 commercial functions performed by the federal government, the limited number of contracts that have been awarded have generated large cost reductions. An exhaustive study by the Defense Department (1984) reviewed 235 service contracts awarded between 1980 and 1982. It found that contracting out trimmed service costs by an average of 30 percent. The dollar savings from the Pentagon's contracting out initiatives rose to over $500 million in 1985 alone. The General Accounting Office, the Congressional Budget Office, and the President's 1982 Grace Commission have unanimously concluded that a more widespread federal contracting out program could reduce federal costs by as much as $4 billion a year.

There are additional advantages to contracting out aside from its budgetary impact. City administrators frequently cite the following benefits from contracting out:

- Contracting out may give the city manager access to specialized skills and worker expertise often unavailable within the government workforce.
- Contracting out accelerates adoption of new technologies and capital equipment that may not yet have been introduced within the government.
- Contracting out may allow the private sector to take advantage of economies of scale in providing a service to more than one city.
- Contracting out can generate greater flexibility in service provision by bypassing normal government bureaucratic regulation and red tape, such as in the hiring and firing of workers.
- Contracting out can serve as a yardstick to measure government "in-house" costs with those in the private sector.
- Contracting out, particularly in the area of human service delivery, leads to greater effectiveness in assuring that program benefits reach program recipients, because neighborhood-based providers are often better equipped to identify and locate needy citizens.

Table 3 shows the results of a survey of over 1,000 city administrators who were asked to list the advantages of privatization.

Factors That Inhibit Service Contracting

■ The reluctance of city officials to contract out for service delivery often arises from two concerns: 1) switching to private providers diminishes public control over the government activity, leading to

[2]Some of the best studies that have estimated the cost savings from contracting out include: Ahlbrandt (1973), Bennett and Johnson (1980), Clarkson, et al. (1987), Crain and Zardkoohi (1978), Hanke (1982), Hirsch (1973), Kemper and Quigley (1976), Los Angeles County Economy and Efficiency Commission (1987), Lowery (1982), Morlok and Moseley (1982), Savas (1977), Stevens (1978), Stevens (1984), Teal (1984), Touche Ross (1987), Whitman (1984).

TABLE 3

Advantages of Contracting Out Municipal Services

	Percent of Respondents Who Listed These Advantages
Cost Savings	74%
Higher Quality Service	33%
Provides Services Not Otherwise Available	32%
Sharing of Risk	34%
Shorter Implementation Time	30%
Solves Labor Problems	50%
Solves Local Political Problems	21%
No Advantages	3%

Source: Touche Ross (1987)

poorer service quality or corruption; and 2) competitive contracting may threaten the government workforce with job loss or reduced wages.

Most researchers agree that when a city contracts out a service it sacrifices a degree of direct control over the activity in order to benefit from the lower budgetary costs associated with going private. The city must, therefore, weigh these two competing factors in deciding whether to put a service out for bid.

The issue of whether contracting out will diminish the quality of service the public receives is of paramount importance to local public officials. A review by the American Federation of State, County, and Municipal Employees (AFSCME) of the cities' contracting out experiences concluded that "private contractors . . . cut corners by hiring inexperienced, transient personnel at low wages, by ignoring contract requirements, or by providing inadequate supervision." An AFSCME (1984) monograph entitled "Passing the Bucks," documents dozens of cases of contractor fraud and service quality problems. These numerous examples indicate that many cities have been negligent in taking precautions to insure that they have selected honest and competent vendors.

Although there have certainly been numerous cases of contracts leading to inferior quality service, the one scientific study that we were able to find that examined the subject has concluded that such instances are the exception rather than the rule. The nation-wide study of municipal contracting by Stevens (1984) found no reduction in service quality in cities that contracted out. In fact, it concluded that "for many of the services, the individuals with the lowest costs of service delivery also achieved among the highest levels of quality."

The only other available evidence comes from surveys of public officials. The California Tax Foundation (1981) surveyed 87 California local government officials involved in contracting out. Over twice as many of the respondents (36) indicated that service quality had improved than complained that the city suffered poorer service (16). A survey by Burgin, Ellerman, and Morlok (1985) of officials from eleven transit agencies that contract out bus service found no reduction in service quality by privatizing.

Cities can ease the problems associated with the sacrifice of public control from contracting out by including explicit performance criteria written into the service contracts they issue. Cities and counties that rely heavily on the private sector to deliver government goods and services have developed sophisticated techniques for protecting themselves against fraud or unsatisfactory service performance. For instance, Phoenix, Arizona—one of the pioneers in service contracting—writes into its service contracts very specific performance criteria that the contractor is obligated to meet, as well as provisions for regularly monitoring the contract. Scottsdale, Arizona, which contracts out approximately 40 percent of its municipal services, draws up contracts that contain rigid performance specifications and a thirty day cancellation clause for unsatisfactory service quality.

As contracting out becomes a more routine management practice and through normal exchange of information among cities, the likelihood is that these successful preventative approaches will become more universally adopted.

The Importance of the Employment Issue

■ By far the most contentious issue associated with contracting out is its impact on public sector workers. The public employee unions—who fear job loss and pressures for reduced wages from competitive contracting—are now vehemently opposed to the practice.

The evidence seems to indicate that the reluctance of many cities to contract out is directly attributable to the objections of the government workforce. Not surprisingly, service contracting is rarest in large cities of the highly-unionized North-

east region of the country, while privatization is flourishing in the West where unions wield less political influence.[3] There is some evidence that the more power the public employee union holds in a city, the less likely it is that the city contracts out for service delivery. For instance, in a study on the determinants of local hospital privatization, Ferris and Graddy (1986) examined a nationwide sample of 185 cities and found that "the degree to which public employees are unionized has a negative and significant effect on the likelihood of contracting out."

Public employee unions are a singularly formidable political constituency, which few elected officials wish to antagonize. For one thing, they vote far more frequently than does the average citizen (Bennett and Orzechowski, 1983; Bush and Denzau, 1977). In addition, as Bennett and DiLorenzo (1983) have emphasized: "If an elected official is in disfavor with bureaucrats, his political career can be indirectly threatened. Politicians rely on civil servants to provide services for constituents."

The strength of public employee unions is growing vis-a-vis other union groups, which has shifted political influence in the direction of government workers. Between 1973 and 1983 membership of unions representing private sector employees dwindled. The United Steel Workers, the United Mine Workers, and the United Auto Workers each lost over 32 percent of their members. In contrast, membership in the American Federation of State, County, and Municipal Employees (AFSCME) grew by 380,000 members, a 66 percent rate of growth. Bernardo (1986) found that in 1960 only one in twenty union members was a government worker; in 1986 one in three was.[4]

On several occasions the public employee unions have used this increased political influence to block state and local privatization initiatives. One common tactic that the unions have employed is to file a lawsuit against the government agency attempting to contract out. In 1986, for instance, the *Washington Post* reported:

> Employees of the National Weather Service, concerned about losing their jobs, are challenging a proposal to turn over part of the weather satellite system to private industry.
>
> The National Weather Service Employees Organization filed suit Dec. 17 in U.S. District Court, seeking an injunction to halt the proposal to have a private contractor operate the ground control portions of the system.
>
> The only way a private company could operate the facility more cheaply than the government would be to bring in lower-paid workers or cut the pay of the people currently on the job, the weather service employees charged.

A similar incident occurred in San Diego County in 1982. County officials attempts to contract out a juvenile delinquency facility were squashed by the county's probation and correction officers' union. The union took the county to court and won by citing an old county bylaw that prohibited private companies from running public facilities.

Even in cases where the union's complaints are eventually invalidated by the courts, injunctions often prevent contracts from being implemented because the private firm loses interest. In another case, New Orleans, Louisiana the employee union waged a public relations campaign against a proposal to contract out the city's emergency medical services. City officials backed off, and no contract was ever issued.

One of the clear implications of such cases is that city officials must develop methods of mollifying or neutralizing public employee opposition to contracting out if they want to rely more heavily on the private sector for the delivery of goods and services. Philip Fixler, Director of the California-based Local Government Center, an organization that monitors trends in privatization and provides consulting services on privatization for cities, has

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[3]The Touche Ross (1987) study found a definite regional imbalance in cities' rate of adoption of privatization. It found that "Governments in the West appear to be undertaking the largest [privatization projects], and those in the North Central states the smallest."
In addition, according to analysis by the Public Service Research Council (1982), "National surveys show contracting-out virtually non-existant in cities where public unions have clout."

[4]These statistics are particularly important because one might presume that a politician faces countervailing forces in determining whether to support contracting out. On the one hand, the public employee union loses; on the other, the size and strength of the private sector unions escalate, to the extent that the workforce of private contractors is unionized. However, the increased relative strength of the public employee unions has slightly tipped the scales in favor of appeasing public employee groups.

emphasized the importance of overcoming the resistance to privatization of the government workforce by warning: "Unless employee-treatment strategies are accorded the highest priority in the privatization process, the growing trend toward privatization may be stymied by increasingly organized and vehement opposition from those most affected by privatization: public employees and their unions." Several cities have begun to adopt innovative employee treatment policies, several of which will be outlined in Section IV.

Overview of the Scope of the Study

■ The remainder of this study is divided into four areas all related to the issue of how privatization affects employment. Section II contains an assessment of the overall quality of the existing literature on the employment effects of contracting out.

Section III identifies seven employment-related issues associated with contracting out and reports the research findings from the available literature in each of these areas.

Section IV presents the findings of our interviews with county and city administrators from jurisdictions that have relied heavily on contracting out in the past. The purpose of these interviews was to collect whatever employment data might be available from governments that have privatized services and to interpret them as best as possible. A second purpose of the interviews was to determine what employment policies cities and counties have developed to ease the concerns of the public workforce that might serve as a model for other government units.

Section V contains tentative policy recommendations and a wide range of potential employment-treatment strategies for government officials who may be confronted with public employees hostile to contracting out.

Section VI is a summary of our conclusions.

Section VII provides a comprehensive bibliography of privatization and employment studies.

Identifying Seven Employment Issues Related to Contracting Out

■ Based upon our survey of the literature, we identified seven employment issues that are most often raised as consequences of privatization. These employment issues are:

- Is there a net job loss from contracting out government activities?
- What is the subsequent labor market experience of government workers whose jobs are contracted out to private firms? And what public assistance benefits do they receive?
- Are the cost advantages of contracting out due primarily to lower wages paid by the private contractors as compared with wages in the public sector?
- How do workers' fringe benefits—such as health care insurance coverage, pension benefits, workers' compensation—offered by private contractors compare with the benefit levels offered to government employees?
- How does the government contractor's use of labor differ from that of the government agency?
- Does contracting out adversely affect women and minorities?
- How many new jobs are created in the private sector through reduced taxes and/or in the public sector through increased service levels made possible from the cost savings resulting from contracting out?

Several of the employment studies presented in the following section do not specifically address the privatization issue but render conclusions that are indirectly applicable to employment questions concerning contracting out. The approach adopted in the following section is to present as wide a view of the available research as possible. Aside from addressing the merits of each employment issue, a secondary purpose of this section is to identify what issues have already been substantively covered in the literature and to suggest where further research is most needed.

SECTION II

Assessing the Strengths and Weaknesses of the Literature on the Employment Implications of Contracting Out

■ The following section summarizes the literature on the subject of the employment consequences of privatization. We spent a total of five weeks reviewing the literature on privatization in the United States. Though this search was primarily directed toward studies on the employment effects of privatization, we also examined studies that examine related issues, such as the extent of privatization, cost savings from privatization, and other advantages and pitfalls of privatization.

An enormous amount of material has been published on privatization over the last five years, both in the academic and general literature. This report contains an extensive bibliography in the appendix. Other comprehensive bibliographies on privatization are included in Chi (1987), Gordon (1984), Fixler (1986), and Rogan, Solomon, and Winslow (1987).

Almost all of the literature identifies the employment issue as one of the most controversial aspects of contracting out services. Yet very few of the studies investigate the employment question scientifically. Hence, we were frustrated in our efforts to discover much reliable data. We were only able to identify about eight studies that deal specifically with some aspect of the employment question. This paucity of research on the subject is surprising given the wide range of complex issues related to the issue of privatization and employment (See the preceding section, for a mapping out of the issues, for instance).

Our survey of the literature included the following steps:

1) We scanned the bibliographies of most major books and articles on the subject of privatization for any studies that might touch on the employment issue.

2) We contacted over twenty of the leading writers and researchers on privatization and asked them to identify any studies on the employment consequences of privatization.

3) We contacted government agencies, including the U.S. Department of Housing and Urban Development, the U.S. Office of Personnel Management, the U.S. General Accounting Office, and the Congressional Research Service, to find out if these agencies had commissioned any studies on the subject.

4) We spoke with members of the research departments of several public employee unions, including the American Federation of State, County and Municipal Employees (AFSCME), to learn of any studies they had done themselves, or were familiar with on the subject. All of the unions that we contacted were cooperative, with the exception of AFSCME. We were able to obtain most of AFSCME's research from other sources, however.

5) We contacted several research organizations, such as the Local Government Center of the Reason Foundation and the Heritage Foundation, that specialize on the issue of privatization, and obtained material and advice from them.

The research that we present in the following section includes statistical studies, case studies, and results of surveys with public officials. We restricted the scope of the search to studies of the domestic U.S. experience with privatization. But we examined studies of all levels of government: federal, state and local.[1] In some cases where there has not been a study addressing the precise issue, we present the findings of studies that bear indirectly on the subject. For instance, because there are so few studies comparing contractor salaries

with government salaries, we were forced as a second best alternative to compare government versus private sector salaries.

After each section we have made an assessment of where there is need for further research.

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[1]Some readers might object that at various stages of this study we discuss "local contracting out," which combines both city and county experiences. This might blur differences between the two levels of government. But there is a theoretical justification for this. Gordon (1984) found from surveys of city and county officials that the two levels of government contract out almost identical services. Gordon obtained a Pearson's correlation coefficient between county and city contracting of .989. He concludes: "It makes as much sense to speak in terms of local government contracting as it does to speak separately in terms of county and municipal contracting. Counties and municipalities contract out for essentially the same services at essentially the same levels of government."

SECTION III

Review of The Literature on The Employment Impact of Contracting Out Government Services

Issue 1. Estimating the Job Displacement Effect From Contracting Out

■ When a service is transferred from the public sector to the private sector, the jobs of public employees who performed that service may be jeopardized. This section will attempt to determine the subsequent job experience of public workers affected by service contracts. In particular we will try to estimate the percentage of affected workers who suffer job displacement from contracting out.

The issue is a tricky one. Most studies have only examined what happens to government workers affected by contracting out immediately after the contract is issued. Hence, if a worker is laid off by the government agency, it is presumed that he becomes unemployed. But there is very little information as to **how long** he is unemployed, which is the relevant policy issue. Similarly, in cases where a government worker takes a job with a contractor, almost none of the research has investigated whether these workers stay with the contractor, or whether they are subsequently laid off and become unemployed. In sum, a general shortcoming of all the research on the issue of job displacement is that it is almost universally short term in nature.

Given this constraint, for the purposes of this study, we will define job displacement as any situation where a government employee is laid off from the public agency and does not have a private sector job at the time that the study is conducted.

The most reliable studies estimating the job displacement effect from contracting out have focused primarily on the federal rather than the state and local experience. However, we feel that the findings from the federal experience can be generalized to the state and local experience to a certain extent for three reasons. First, on balance, the same types of commercial services are contracted out on the federal level as on the local and state level. The one exception to this is that the states are much more heavily involved in contracting human services than is Washington. Second, the skill and pay levels of federal workers, on average, are comparable to those of the state and local government workforces. Third, the federal government contracting policy in regard to employee treatment is similar in several respects to the policies of lower levels of government that are involved in contracting out.

The U.S. Department of Defense (DOD) has been heavily involved in contracting out services for over ten years. The single most comprehensive study of job displacement resulting from contracting out was conducted by DOD (1984). The Pentagon reviewed all 235 service contracts it awarded between October 1, 1980 and October 1, 1982. These contracts saved the Pentagon approximated $250 million. The jobs of 9,650 federal workers were affected. The job status of these federal employees in 1984 was found to be as follows:

- 9,035 workers, or 94 percent of the total, were either placed in other government jobs or retired voluntarily.
- 615 workers, or 6 percent, were involuntarily displaced from government service.
- About half of these 615 displaced workers, or 3 percent of the total affected workforce, were hired by the private contractors.
- Slightly over 3 percent, or 300 workers, were displaced by the government contracts.

The Department of Defense (1985) conducted a follow-up study examining 131 service contracts it awarded to private firms during fiscal year 1984. This second study yielded nearly identical results. The main finding was that only 5 percent of the

TABLE 4

Department of Defense Contracting: Fiscal Year 1984/Summary of Impact on Affected Employees

	ARMY	NAVY	AIR FORCE	TOTAL
Affected Employees	**1,140**	**1,425**	**695**	**3,327**
Employees Separated From Government Employment	**282**	**119**	**0**	**401**
Employees Accepting Jobs With Winning Contractors	**193**	**46**	**0**	**239**
Percent of Employees Displaced	**8%**	**5%**	**0%**	**5%**

impacted federal employees lost their jobs. Table 4 presents the results broken down for the Army, Navy and Air Force.

A final study of Pentagon contracting was conducted by the U.S. General Accounting Office (GAO) (1985a), which has published several extensive reviews of contracting out at the Department of Defense (DOD). The GAO examined 20 commercial functions that were converted to contract between 1978 and 1981. The study surveyed 2,035 affected federal employees. This included not only employees directly affected, but also 421 workers whose jobs were indirectly affected by the shifting of federal employees into other jobs. Five percent of the affected workers were displaced. The results are shown in Table 5.

TABLE 5

Job Displacement from Defense Department Contracts

Job Status	Number	Percent
Obtained Other Government Position	**1,881**	**74%**
Retired	**298**	**12%**
Went to Work for Contractor	**171**	**7%**
Resigned	**53**	**2%**
Involuntarily Separated	**129**	**5%**
Other	**3**	**0%**
TOTAL	**2,535**	

This study may overestimate the percentage of workers who became unemployed. It did not investigate how many of those who were "involuntarily separated" were able to find another job in the private sector. It is reasonable to assume that many did.

The federal domestic agencies have had a much more limited experience with contracting out services. Generally, the domestic agencies have had a poorer success rate than the DOD of protecting the jobs of government workers affected by contracts. The results vary markedly across agencies.

An agency-wide analysis of federal contracting out was conducted by the U.S. Office of Management and Budget (1986). This study reviewed the contracting out experience between fiscal year 1982 and fiscal year 1985 in ten domestic federal agencies to determine the number of employees who subsequently lost their jobs. The OMB's conclusions for each agency were as follows:

- Five of the agencies (the Treasury Department, the Environmental Protection Agency, the Department of Health and Human Services, the Agency for International Development, and the Department of Transportation) had limited contracting out programs, but were able to place all affected employees in another government position, or in a job with the private contractor.
- The Army Corps of Engineers had contracts affecting 300 workers; only 6 (or 2 percent) were involuntarily separated.
- The General Services Administration, which has had the largest contracting out program outside the Department of Defense, issued contracts affecting 771 workers, of whom 109, or 14 percent, were involuntarily separated.
- Commerce Department issued contracts affecting 211 employees; of these, 46 (21 percent) were involuntarily separated.
- The Interior Department had the poorest placement record; of 267 employees adversely affected by service contracts, 107 (40 percent) were displaced.

It is again worth emphasizing that just because a federal worker was involuntarily separated does not necessarily mean that he was rendered unemployed. No information is available about the sub-

sequent labor force experience of those workers who were involuntarily separated.

An overall assessment of the federal contracting out efforts yields the conclusion that, except for agencies with very limited contracting out programs, few workers have become unemployed because of service contracting. On average, only about one in twenty of all affected workers was displaced by federal contracts with the private sector. Even with these low rates of displacement, and even incorporating the costs of retraining and the costs associated with transferring workers to other government positions, these contracts generated cost savings in the 20 percent to 30 percent range.

A major reason that the federal government has had such a high rate of success in preventing job displacement is that the official federal policy statement on contracting out, "OMB Circular A–76," requires that certain accommodations be made for affected workers. In particular, the policy directive requires that "the contractor will give federal employees, displaced as a result of conversion to contract performance, the right of first refusal for employment openings on the contract for positions for which they are qualified."

The federal government has also established a comprehensive network of programs and services available to federal employees affected by contracting out, which also explains the low displacement levels it has achieved. According to the Office of Management and Budget (1986) these policies include:

- Giving priority consideration to affected workers for positions within the agency.
- Freezing the filling of vacant agency positions whenever a reduction in force due to contracting is imminent.
- Enrolling affected employees in OPM retraining programs, the Interagency Placement Assistance Program, and/or the Displaced Employees Program.
- Granting administrative leave and other assistance for the job search efforts of affected workers.
- Offering job search training for affected workers.
- Working with contractors to match job qualifications of affected workers with contractor's job vacancies.

On the local level, no systematic multi-city study has investigated the magnitude of the employment displacement effect of contracting out. More research is needed in this area. In Section IV we present several case studies that provide job displacement data for individual contracts in individual cities.

The case of Los Angeles County deserves special mention here, however, because of the immense size of its contracting out program (645 contracts since 1980) and because it has published detailed data on what has happened to the county's affected workers. Los Angeles County contracts out more services than any other county in the country; these contracts now produce $133 million in cost savings each year. The County's Economy and Efficiency Commission (1987) found that only 3 percent of the affected workers lost their jobs. The data is compiled in Table 6.

The only research that we were able to find that addresses the issue of job displacement across cities was a survey of 87 California local public officials by the California Tax Foundation (1981). The survey found that displacement of employees did not constitute a major problem. Only 11 percent of the officials listed "Displacement of Employees" as a disadvantage of contracting out.

TABLE 6

Summary of Job Displacement Resulting from Los Angeles County Contracting, 1982–1986

Classification	Number	Percent of Affected Workers
Employees Placed With County	**1061**	**80%**
Employees Who Left County Service Voluntarily	**96**	**7%**
Employees Placed With Contractor	**128**	**10%**
Employees Laid Off	**36**	**3%**
Total Affected Employees	**1320**	

As mentioned earlier, there is very little research on the length of time that government workers who are laid off due to contracting out remain unemployed. Some evidence comes from the Los Angeles County Commission on Economy and Efficiency (1987), which reported that in 1987 two-thirds of the workers laid off by contracts issued between 1982 and 1986 were working again for the county.

Slightly greater insight into the issue was supplied by the U.S. General Accounting Office (1985). In early 1985 the GAO interviewed 94 workers who had been laid off due to the federal government contracting out their functions in 1983. Of these 94 workers, 62 (or 66 percent) were working at the time of the interview, and 11 (or 12 percent) had retired voluntarily. Thus, two years after the contract had been issued, only 22 percent of the workers laid off because of contracting out were unemployed.

The General Accounting Office (1985) study also examined the flipside of this issue by interviewing 130 former government employees who went to work for the contractors to determine how many had retained employment with the private company. Two years after the workers had joined the private contractor, only 4 had been involuntarily separated and were without work. The results of the survey are summarized in Table 7.

TABLE 7

Employment Status Two Years Later of Federal Workers Who Went to Work For Contractors

Employment Status	Number	Percent
Currently with Contractor	74	57%
No Longer with Contractor:		
Obtained Federal Job	37	28%
Involuntarily Separated	4	3%
Resigned/Retired	7	5%
Obtained Better Job	3	2%
Other	5	4%
Total	56	43%
Total Respondents	130	

To summarize the research on job displacement effects of contracting, the following conclusions can be made:

1) The federal experience with contracting out indicates that the job displacement effect is very low—with only about one-in-twenty affected workers becoming unemployed due to the transfer of the service to the private sector.

2) No multi-city research has been conducted to provide a reliable estimate of the job displacement effect of local contracting out. There is considerable room for additional research in this area.

3) Los Angeles County, which has initiated over 600 service contracts since 1980 has kept job displacement levels to less than 3 percent.

4) Surveys of city officials reveal that most do not view job displacement of municipal employees as a major drawback of contracting out.

5) Only limited research has been conducted that tracks the subsequent job experience of those workers who are laid off by service contracts and those who go to work for the private contractor. Two years after federal contracts had been issued, only 22 percent of those who were laid off were unemployed. Only about three percent of federal workers who joined a private contractor were jobless two years later. More research is needed to address the critical issue of how long workers who are displaced by service contracts remain unemployed.

Issue 2. Public Assistance To Displaced Public Employees

■ A related labor-market concern is the amount of public assistance received by public employees who become displaced as a result of a service contract. AFSCME (1985) phrases the issue this way: "Contracting out sometimes involves laying off public employees who previously performed the service, but this, too, entails costs. Laid-off public employees are entitled to unemployment compensation paid by the employer. Some laid-off workers, because of their economic circumstances, may also qualify for various public welfare programs."

The limited evidence seems to indicate that such payments to affected government workers are relatively small. The only study that has directly examined the issue was conducted by the General Accounting Office (1985b). When the GAO interviewed 94 "involuntarily separated" federal employees who had worked for the Department of Defense it inquired as to how much unemployment compensation, food stamps, Aid to Families

with Dependent Children, and Supplemental Security Income they had received. Of these 94 individuals, 53 (56 percent) had collected unemployment compensation or public assistance due to the lay off. The GAO estimated the total cost of this public assistance was $215,000.

These public assistance payments, however, are only meaningful in a public policy context when viewed in relation to the total amount of public funds saved by the contracting out. Only if the public assistance payments to these workers approach or exceed the budgetary savings from the service contracting that necessitated these payments, would they have a bearing on the determination as to whether contracting out is cost effective.

The total savings from these Defense Department contracts was $65,484,000. Thus public assistance payments canceled out only 0.4 percent of total budget savings. The GAO concluded from these figures that: "Including these costs in the cost comparisons would probably not have affected the decisions to contract out the functions." The GAO study did not even attempt to take into account estimates for the number of workers who might have been taken off public assistance due to the expansion in employment opportunities in the private sector.

Issue 3. The Impact of Contracting Out on Wages

■ According to an assessment by the U.S. Office of Personnel Management, one of the primary reasons that public employees are hostile to the idea of contracting out is: "Savings gained from contracting out are often due to private businesses . . . paying [salaries] less than agencies." Dantico and Jurik (1987) levy a similar charge against contracting out:

> Comparisons of similar private and public service providers indicate that private firms rely more heavily on unskilled labor than do governments. While on its face the work to be done appears to be the same, jobs are frequently redefined with a resulting "dumbing down" of positions. This results in lower pay scales for entry-level workers in the private sector.

This section investigates whether private contractors offer lower pay scales than do government agencies, and if so, how much lower.

It is extremely difficult to make any broad generalization as to how much higher or lower government wages are than those of private contractors, because the differences observed vary widely across services. For most commercial services that are routinely contracted out, it is safe to conclude from the existing research that wages paid by private contractors are generally lower—but not significantly lower, on average—than the wages paid by the government.

One factor that hikes the wage rates of private firms receiving federal contracts is that they must comply with minimum salary requirements. The Davis-Bacon Act requires all firms receiving federal contracts of over $2,000 for construction work to pay their workers an area "prevailing wage rate" as established by the U.S. Department of Labor. The Service Contract Act requires contractors to pay prevailing wage rates for all service contracts of over $2,500. These laws set a floor for salary levels

TABLE 8

Comparison of Federal Personnel Costs With Overall Contract Cost for Six Contracted Out Defense Services

Installation	Function	In-House Personnel Costs	Contract Cost	Percent Difference
Fort Knox	Food Service	**$6,913**	**$6,715**	**3%**
Fort Gordon	Base Operations, Housing Services	**$98,137**	**$86,555**	**12%**
Fort Lee	Food Service	**$14,820**	**$12,826**	**13%**
Fort Dix	Laundry, Dry Cleaning	**$2,880**	**$2,204**	**23%**
Seymour Johnson AFB	Food Service	**$1,486**	**$1,005**	**32%**
Fort Hood	Aircraft Maintenance	**$5,721**	**$2,826**	**51%**

TABLE 9

Comparison of Federal Salaries With Contractor Salaries Based Upon Surveys of Former Federal Employees

Contractor Wages Were:	Total Respondents No.	(%)	Contractor Versus Federal Agency Wages: Difference Less than $1,000 No.	(%)	Difference $1,000–$3,999 No.	(%)	Difference More than $4,000 No.	(%)	Not Answered No.	(%)
Lower	69	(53)	16	(12)	37	(29)	11	(8)	5	(4)
The Same	32	(21)	—	—	—	—	—	—	—	—
Higher	27	(21)	6	(5)	13	(10)	8	(6)	0	(0)

paid by firms performing federal contracts. It is not clear, however, whether these floors are above or below federal pay rates.

Several studies have compared the salary levels of private contractors with the pay rates of federal workers. The General Accounting Office (1981) reviewed 12 Department of Defense contracts to determine the source of the savings by contracting out. GAO's conclusion was as follows: "The cost savings by contracting out were generally attributable to differences in personnel costs between in-house and contractor performance. The contractors generally planned to use fewer employees and pay them less." Unfortunately, this study did not provide data to quantify how much lower the private contractors' salaries were. The GAO did, however, provide a comparison of total spending by the federal agency on personnel costs with the total contract award for six contracts; the results are displayed in Table 8. The total contractor price is substantially lower than the in-house personnel costs for every contract but one. Clearly the personnel costs of the contractors were significantly lower. But this does not indicate whether these reduced labor costs are due to reduced wages, or to other factors, such as lower fringe benefits, or use of fewer workers.

A second GAO study (1985) provided considerably more direct evidence bearing on the issue of wage disparities between contractors and federal agencies. The GAO surveyed 128 former federal employees who took jobs with private contractors and asked them to compare their former and current wages. The results are broken down in Table 9.

These results indicate that over half of the federal employees who went to work for a private contractor received lower wages, but over 20 percent of the workers who left for the private sector received pay increases.

We performed a simple calculation to quantify the wage differential implicit in this data by taking the following steps. We assumed that the average pay raise or reduction for those falling in the "Less than $1,000" category was $500; that the average pay raise or reduction for those falling within the "$1,000 to $3,999" category was $2,500; and the average pay raise or reduction for those falling in the "More than $4,000" category was $6,000. We then calculated an average salary change. The result: the average federal worker who moved into the private sector suffered an annual salary reduction of about $650. For most service workers this would be less than a six percent pay cut.

One possible explanation for the lower wages paid by contractors is that many federal workers are overgraded—that is, they are overqualified for the tasks they are performing. The U.S. Office of Personnel Management (1984) found that 14 percent of all federal workers are overgraded. Thus, when these positions are converted to contract, the private firm is able to pay workers less for comparable positions.

Studies of local contracting have generally discovered pay differentials between government and contractor, but again the results vary widely across services. Perhaps the most comprehensive study on the subject was undertaken by Stevens (1984). Stevens compared the cost of providing eight different municipal services in ten California cities that contract out with ten California cities that provide the service in-house. The breakdown of salary levels for each of the eight services Stevens analyzed is shown in Table 10. For seven of the

TABLE 10

Comparison of Wages Between Local Government and Private Contractors, for Eight Services

Service	Average Monthly Wage for Laborers Contractor	Municipal Agency	Percent Difference
Payroll	**$2,083**	**$2,375**	**12%**
Asphalt Overlay	**$2,421**	**$1,532**	**-58%**
Refuse Collection	**$1,237**	**$1,418**	**13%**
Street Cleaning	**$1,576**	**$1,612**	**2%**
Janitorial	**$881**	**$1,234**	**29%**
Traffic Signal Maintenance	**$1,500**	**$1,721**	**13%**
Street Tree Trimming	**$1,390**	**$1,475**	**6%**
Turf Management	**$956**	**$1,237**	**23%**

eight services examined, the private contractor pay levels fell below the municipal government pay rates. In two cases—turf management and janitorial services—the private contractors' salaries were significantly lower than the salaries paid by the municipal agency. For asphalt overlay, on the other hand, the private contractors' pay rates were considerably higher than the pay rates of the government.

Peterson, Davis, and Walker (1986) examined wages in the public and private transit industries and found even wider disparities. The authors compared the pay scales for public, unionized private, and nonunionized private bus drivers and bus mechanics in eight large U.S. cities. The average wage differentials that emerged from this study were substantial; they are shown in Table 11.

TABLE 11

Comparison of Public Versus Private Transit Wages

	Dollars	Percent
Amount that Public Salaries Exceed Private Union Salaries		
Bus Drivers		
Bus Mechanics	**$3,100**	**15%**
Amount That Public Salaries Exceed Private Non Union Salaries	**$6,500**	**55%**
Bus Drivers	**$8,900**	**30%**
Bus Mechanics	**$11,900**	**41%**

In the transit area the savings from contracting closely reflect these salary disparities. A study by Charles River Associates (1986) of municipal transit contracting concluded that lower contractor prices for this service was a result of three factors: 1) reduced wage rates; 2) lower overhead costs; and 3) increased labor productivity. The wage reductions for this service were fairly steep: the average municipal transit employee received $11 to $13 per hour, while private operator wage rates were in the $7 to $8 per hour wage range.

The Los Angeles County Economy and Efficiency Commission (1987) compiled statistics comparing the wage rates for County service employees and service employees working for private firms in the Los Angeles area. It examined two occupations commonly contracted out: custodial services and food services. The results, shown in Table 12, were that for comparable work the private sector employees received wages up to 30 percent higher than the County employees. However, it should be noted that contractors tended to pay slightly below the average for private sector employers.

The only other comprehensive comparison between wages paid by local governments versus private vendors was conducted by the Joint Center for Political Studies (1985). Using a case study method and examining several municipal services, including recreational services, vehicle maintenance, and emergency medical care, this study also reported lower wages paid by contractors overall. Unfortunately, the Joint Center did not quantify these wage disparities, and they were not tested scientifically.

TABLE 12

Comparison of Private Sector and Government Pay in Los Angeles County

	Hourly Wages L.A. County Government	B.L.S.* (Area Wages)	M&M Survey** (Area Wages)
Custodian	**$7.45**	**$7.26**	**$11.60**
Custodian Supervisor	**$9.28**	**N.A.**	**$12.92**
Food Service Worker	**$5.50**	**$6.06**	**N.A.**

*Bureau of Labor Statistics, "Area Wage Survey: Los Angeles, Long Beach Metropolitan Area," October, 1985.
**Merchants and Manufacturers Association, "Wage Survey, 1986."

The study found that only in the case of skilled craft workers did workers earn comparable wages. For some services, such as maintenance, the private contractor pay levels were only half that offered by the municipal agency. However, these wage disparities "narrowed significantly" when the service workers were unionized. The report's Executive Summary concludes: "Generally, minority workers earned less with alternative service providers than as municipal employees."

TABLE 13

Change in Earnings of Federal Workers Affected by Service Contracts, Who Retained Employment With The Government

Pay Grade Assignment After Contracting Out	Number	Percent
Lower Pay Grade	**1,049**	**56%**
The Same Pay Grade	**806**	**43%**
Higher Pay Grade	**26**	**1%**
Total	**1,881**	

Thus far we have compared the wages of private contractors with those of government agencies and have found that generally wage rates fall when the service is contracted out. A related issue is: What happens to the wage rates of affected government workers who are transferred to other government positions? Are these workers typically placed in higher or lower paid positions? Two studies have addressed this issue—one on the federal level, and one on the county level. They provide contradictory findings.

The previously-cited General Accounting Office (1985) survey of federal service workers affected by service contracts found that those workers who remained in government often received lower wages in their new positions than they did in their old jobs. Of 1,881 surveyed, 56 percent suffered a pay cut after reassignment. The survey results are shown in Table 13. Unfortunately, the survey did not reveal **how much lower** the wages of these workers were after they were reassigned to new jobs.

The experience in the County of Los Angeles has been precisely the opposite. The Los Angeles County Economy and Efficiency Commission (1987) found that far more workers were promoted than demoted, as shown in Table 14.

TABLE 14

Subsequent Wage Levels of Affected Government Workers Who Retained Employment With Los Angeles County

Job Status of Employees Who remained With County	Number	Percent
Employees Demoted	**32**	**3%**
Employees Who Received No Grade Change	**805**	**76%**
Employees Promoted	**224**	**21%**
Total	**1061**	

Overall, these studies suggest that in most cases the jobs created by contracting offer lower pay levels than the public positions they replace. These wage disparities differ substantially across

TABLE 15

Comparison of Six Fringe Benefits: Federal Government Versus Private Contractors*

Benefit Type	Better With Government		Better With Contractor		About The Same	
	No.	(%)	No.	(%)	No.	(%)
Retirement	**113**	**(87)**	**7**	**(5)**	**4**	**(3)**
Sick Leave	**105**	**(80)**	**9**	**(7)**	**10**	**(8)**
Vacation	**99**	**(76)**	**6**	**(5)**	**16**	**(12)**
Life Insurance	**79**	**(61)**	**18**	**(14)**	**22**	**(17)**
Health Insurance	**71**	**(54)**	**31**	**(24)**	**18**	**(14)**
Holidays	**46**	**(35)**	**12**	**(9)**	**62**	**(48)**

*Percentages do not add to 100 because of those who provided no answer.

services; for several services private sector pay was found to be more generous than that offered in the public sector, for other services the public sector pay levels were twice as high as wage levels paid by contractors. Government workers who are placed in new job assignments as a result of service contracts do not necessarily suffer cuts in their salaries; the experience in Los Angeles County indicates they are more likely to be transferred to a higher level government position.

Issue 4. Comparison of Government and Private Contractor Fringe Benefits

■ When comparing the labor compensation provided by government with that provided by private contractors, it is important to factor in not just wages, but also fringe benefits. Fringe benefits make up a very large portion of federal employees' total compensation package, making this issue extremely important to them. Benefits constitute about 50 percent of wages for public transit workers, for instance, versus 25 percent to 33 percent for the typical private transit worker.

Any disparity in wages between government agencies and private contractors is likely to be widened when benefits are included into the calculation. Government fringe benefit packages are more generous on balance than benefit packages offered to equal-skilled employees who work for private contractors.

The most complete study of benefit comparisons on the federal level was conducted by the GAO (1985). The GAO surveyed former federal employees who had taken jobs with private contractors and asked them to compare their federal benefits with those they were now receiving in the private sector. For five of the six benefits examined, government benefits were found to be more generous, as shown in Table 15.

A study by the Hay/Huggins Company (1984)—a Washington-based consulting firm—compared six fringe benefits between the federal government and the private sector; it agreed that, overall, the government's benefits were superior. However, for certain types of fringe benefits, the private sector was more generous than federal agencies. The results are summarized in Table 16.

TABLE 16

Federal Versus Private Sector Fringe Benefits

Benefit Type	Extent to Which Federal Benefits Exceed Private Benefits as % of Payroll
Retirement	**6.4%**
Life Insurance	**−0.3%**
Disability	**−0.7%**
Health Benefits	**−2.2%**
Executive Perquisites	**−1.2%**
Annual Leave	**+0.8%**
Overall Benefit Package	**+3.1%**

One reason that public sector benefits are more generous than private sector packages is that the public sector devotes a greater percentage of its

TABLE 17

Fringe Benefits for Bus Operators, 1985: Public, Private Union, and Private Non-Union

Benefit Type	Percentage Amount that Public Compensation Exceeds that of the Private Sector: Private Union	Private Non-Union
Health	**139%**	**401%**
Retirement	**59%**	**207%**
Leave	**120%**	**213%**
Overtime Pay	**133%**	**222%**

TABLE 18

Fringe Benefits for Bus Mechanics, 1985: Public, Private Union, and Private Non-Union

Benefit Type	Percentage Amount that Public Compensation Exceeds that of the Private Sector: Private Union	Private Non-Union
Health	**154%**	**383%**
Retirement	**135%**	**232%**
Leave	**156%**	**393%**
Overtime Pay	**25%**	**87%**

total employee compensation package to fringe benefits. The General Accounting Office (1985) reported that civil service retirement benefits cost the federal government 28 percent of basic pay; in the private sector the typical pension program constitutes only 18 percent of pay on average.[1]

The monetary value of public sector fringe benefits is also higher than those offered in the private sector on the local level for most services. For transit workers the differences in benefit packages have been particularly pronounced. Tables 17 and 18 show the average differential across eight cities—Boston, Los Angeles, New York, Washington, Chicago, Seattle, Detroit, and Houston—for four fringe benefits.

The interpretation of these tables is as follows: in 1985 public bus operators received health benefits in dollars that were 139 percent higher than those of private union bus operators, and 401 percent higher than those of private non-union operators.

Several additional studies have corroborated the finding that private sector contractors provide more limited fringe benefits than the public sector. Fisk, Kiesling, and Muller (1978) discovered that for comparable entry-level positions, fringe benefits were lower in the private sector than in government. Case studies conducted by the Joint Center for Political Studies (1985) also concluded that private contractors were able to undercut the cost of municipal agencies by offering workers lower benefits, particularly less generous pensions.

There is, however, one exception to this general finding. Stevens (1984), based upon her study of eight municipal services, discovered that the dollar value of fringe benefits offered by municipal agencies and private contractors that replace them were about equal. Steven's overall conclusion concerning fringe benefits was: "The average difference in fringe benefits paid does not account for cost differences between contractors and municipal agencies—contractors paid workers an average of $551 per month in benefits, while municipal agencies paid workers an average of $524 per month in benefits." Again, this study's findings conflict with the bulk of the evidence we were able to uncover.

Given the disparities in wages and fringe benefits, how much more generous is overall compensation for government workers than contractors? Unfortunately, none of the studies we found compared overall compensation packages for government agencies versus private contractors.

However, Bellante and Link (1981) have compared the total compensation offered by federal, state, and local governments with compensation offered by all private firms (not just contractors) for equally skilled and educated workers. Bellante and Link's study was conducted in three stages. In the first stage they compared just salaries; in the second stage they compared salaries and benefits; and in the third stage they compared salaries, benefits, and a pay adjustment for the difference in the probability of unemployment. For each level of government, for both sexes, the total compensation is higher in the public sector than in the private sector. The results based on 1975 data are

[1]This feature of federal civil service retirement benefits builds into the employee compensation package an incentive to stay with the government. The federal pension program therefore may promote employee resistance to contracting out.

TABLE 19

Comparison of Public Versus Private Hourly Wages And Benefits

Type of Compensation:	Group	Percentage Amount That Public Compensation Exceeds That of The Private Sector Federal	State	Local
Wages	Total	20%	2%	−1%
	Males	18%	−3%	−4%
	Females	24%	8%	2%
Wages and Fringe Benefits	Total	23%	6%	1%
	Males	21%	1%	−2%
	Females	27%	12%	4%
Wages, Fringe Benefits, and Lower Probability of Unemployment	Total	29%	13%	10%
	Males	29%	7%	6%
	Females	29%	20%	14%

summarized in Table 19. Total compensation is 29 percent higher on the federal level, 13 percent higher on the state level, and 10 percent higher on the local level than private sector compensation.

In sum, government benefits tend to be significantly more generous than those of the private sector at all levels of government. When services are contracted out, the new jobs created by the private sector offer workers a smaller benefit package than that offered by the government positions that were replaced. For some services, fringe benefit levels have been found to be over twice as high for public sector workers than contractor workers. It appears that retirement benefit costs are substantially lower for contractors than government agencies; this at least partially explains the cost differential between government and contractor-provided services.

Issue 5. How Contractors Differ From Government in Their Use of Labor

■ This section will attempt to identify the factors that enable private contractors to provide services more cheaply than government. Two factors, lower wages and less comprehensive fringe benefits, were discussed in previous sections. But an equally important factor that has been consistently identified in the literature as a major source of budget savings from contracting out is the private sector's more efficient use of labor.

Stevens (1984) compared the work routines of municipal government agencies and private firms that had won municipal service contracts. Stevens isolated ten factors that explained much of the lower costs facing private sector contractors vis-a-vis government agencies. She concluded that these factors had a greater influence in reducing the private contractors' costs than paying lower wages. On average, private firms that had won municipal service contracts were able to cut labor costs in the following ways:

1) Private contractors production techniques were less labor intensive than those of government in-house agencies.
2) Private contractors offered shorter vacations than the government.
3) Private contractors made more frequent use of incentive pay systems than municipal agencies.
4) Private contractors were better able to control the quality of work performed because they had greater flexibility in firing workers than the government.
5) Private contractors generally employed a younger workforce that had accumulated fewer fringe benefits and that had less seniority.
6) Private contractors' employees had lower rates of absenteeism than government service workers.

The data underlying these conclusions are presented in Table 20. For each of these employment factors, the differences between the municipal average and the contractor average were tested statistically and found to hold at the 95 percent confidence level.

TABLE 20

Comparisons of The Use of Labor: Service Contractors Versus Municipal Agencies

Variable:	Mean Value Service Contractor	Municipal Agency
Percent of cost to direct labor	**49%**	**60%**
Vacation days per worker	**10 days**	**14 days**
Percent of cities with incentive systems	**27%**	**12%**
Percent of cities where foremen can fire workers	**54%**	**16%**
Average age of workers	**32**	**36**
Average tenure of workers	**5.8 years**	**8.1 years**
Percent of workers absent	**8.8%**	**12.8%**

A second study by Handy and O'Connor (1984) of the differences in the use of labor between government agencies and private contractors produced similar findings. This study was commissioned by the Department of Defense and is entitled "How Winners Win: Lessons Learned from Contract Competitions in Base Operations Support." It examined U.S. Department of Defense contracting of two military base services to determine the methods used by private contractors to undercut the costs of government agencies.

The overall conclusion of the authors based upon 14 case studies of cost reductions resulting from contracting military base services was that: "Winners win by being innovative, by familiarizing themselves thoroughly with their responsibilities, and by structuring their activities to meet those responsibilities as cost effectively as possible. They change standard procedures and standard organizations where logic dictates that changes will reduce costs."

More specifically, the study identified several labor-related characteristics of winning contractors that explain in part the reductions in cost they were able to generate. These characteristics were:

- Private contractors are more likely to use working supervisors "who not only direct and schedule workers but also perform direct labor themselves."
- Private contractors rely more heavily on multi-skilled workers enabling them to respond more efficiently to "periodic changes in workload [and] increase the productivity of workers whose jobs have extensive amounts of slack time."
- Private contractors cut labor costs by using lower skilled workers when doing so would not lower the quality of service provided. "In most instances, this action was taken after in-house management engineers had conducted a thorough analysis of the work performed and determined that some positions were graded at a higher level than required."
- Private contractors are more prone to cut out unnecessary work—without sacrificing service quality—thus reducing the workload.
- Private contractors make heavier use of overtime "to allow for reductions in manpower hours." Some managers considered sections that did not make use of overtime as being overstaffed.
- Private contractors encourage the use of part-time labor for jobs that do not require full-time staff, while part-time labor is generally a neglected resource under in-house operations.
- Private contractors were less constrained in hiring and firing workers. "Contractors respond quickly to fluctuations in personnel needs, hiring expeditiously when it becomes obvious that additional manpower is needed and releasing employees when manpower levels are too high." Contractors were also quick to fire employees when their performance was unsatisfactory.

Both of these studies dealing with the characteristics of successful service contractors are extremely limited in their scope, and caution therefore must be used in generalizing the findings of the studies to other service activities. But the limited profiles of winning contractors they present suggest that expansions in service contracting will have several implications for changes in employment opportunities in the services sector of the economy. As governments transfer additional service activities to the private sector some of the following changes in the composition of the service sector workforce might be expected:

1) Service workers will be multi-skilled with more generalizable talents.
2) Service workers will tend to be younger with

TABLE 21

Comparison of Government Employment Rates: Whites, Blacks, And Hispanics

	Percent of Workers 16 Years and Over Employed by Government					
	1980			1970		
	White	Black	Hispanic	White	Black	Hispanic
Level of Government:						
Federal	**3.4**	**7.4**	**3.7**	**3.9**	**7.2**	**4.8**
State	**4.3**	**6.6**	**3.4**	**3.9**	**4.2**	**3.0**
Local	**8.2**	**13.1**	**8.0**	**7.7**	**9.8**	**6.4**
Total	**15.9**	**27.1**	**15.1**	**15.5**	**21.2**	**14.2**

less tenure because of the higher labor turnover rates of private contractors.

3) Salaries for service workers will be slightly lower and will be more prone to be tied to incentive pay systems.

4) More service work will be performed by part-time or temporary workers.

Issue 6. The Effect of Contracting Out on Minorities and Women

■ In 1985 the Joint Center for Political Studies conducted a major study for the U.S. Department of Housing and Urban Development entitled: "Alternative Service Delivery Systems: Implications for Minority Economic Advancement." The researchers used a multiple case study method to analyze the impact on minorities of contracting out in 10 cities. Each of the cities selected had a population of at least 50,000, with at least 20 percent of residents being minorities.

The study yielded several conclusions regarding the effect on minorities of municipal contracting. They were:

1) Blacks are more vulnerable to the adverse consequences of "alternative service delivery" approaches because they constitute a disproportionate share of the government workforce. Table 21, taken from the study, shows that they are about twice as likely than whites to work for the government.

2) Hispanics are not likely to be disproportionately impacted by contracting out. They have rates of government employment equal to or slightly below the rates for whites, as shown in Table 21.

3) A much higher percentage of blacks in high skill managerial and professional positions (53.5 percent) are employed by the government than is true of whites (28.9 percent) or Hispanics (33.4 percent). The authors conclude from this that contracting out might impede black professional employment opportunities to a greater extent than it does such opportunities for whites and Hispanics. Table 22 shows the data.

TABLE 22

Percent of Managerial and Professional Workers Employed by Public Sector Versus Private Sector, 1980: by Race And Spanish Origin

	Percent Employed By:	
	Public Sector	Private Sector
Black	**53.5**	**42.9**
White	**28.9**	**62.4**
Hispanic	**33.4**	**58.9**

4) The evidence did not support the contention that the adverse employment impacts of contracting out fall disproportionately on blacks. Generally, when municipal employment was reduced in the 10 cities studied: "The proportion of minorities employed in the municipal workforce remained relatively stable." However, the percentage of minorities in professional positions was reduced by contracting out.

5) Minorities were found to have gained employment opportunities with private sector contractors at about the same proportion as they do

TABLE 23

Impact of Federal Contracting on Whites Versus Minorities

Total Federal Workforce		Employees Affected		Obtained Other Government Job		Employed by Contractor		Involuntarily Separated	
	%	Number	(%)	Number	(%)	Number	(%)	Number	(%)
Race:									
White	78	1,635	(64)	1,260	(67)	110	(64)	53	(41)
Minority	22	811	(32)	566	(30)	52	(31)	71	(55)
Unknown	—	89	(4)	55	(3)	9	(5)	5	(4)

with government departments. As the authors put it: "In services where minorities were heavily employed by city departments, they were also heavily employed by alternative providers. In services where cities employed few minorities, alternative providers employed few."

This would indicate that private contractors do not discriminate against minorities in their hiring practices.

6) Minorities who went to work for private contractors generally received lower pay and less generous benefits than what they received working for the government. But when the private service workers were unionized these wage and benefit disparities were reduced significantly.

The overall conclusion of this study was stated as follows: "Alternative service delivery is not inherently detrimental to minorities. . . . But as long as opportunities for minority economic advancement are heavily concentrated in the public sector, reducing the size of government may curtail an important avenue of social and economic mobility for minorities." Hence, contracting out only adversely affects blacks to the extent that they are more likely to be public employees.

Conversely, Hispanics are harmed less than whites or blacks from alternative service delivery approaches since they are not highly-represented in the government workforce.

The General Accounting Office (1985) found that federal contracting out has had a marked impact on minorities. Its survey of affected federal workers from contracting out found that while minorities (blacks and Hispanics) compose 25 percent of the federal workforce, 32 percent of those employees affected by contracting out were minorities, and 55 percent of those involuntarily separated from the federal workforce, were minorities. The data is shown in Table 23.

The Los Angeles County Economy and Efficiency Commission (1987) also examined the issue of the impact of contracting out on minorities. It found that 87 percent of the over 1,300 affected workers from contracting out in the County were members of an ethnic minority group. Only 50 percent of the County's overall work force is a member of a minority group. The data is shown in Table 24. In contrast to the study by the Joint Center for Political Studies, even Hispanics were found to be disproportionately impacted by contracting out. Yet, the job displacement suffered by these workers was only of a short term nature: almost all found other jobs with the County or the contractor.

The issue of the impact of contracting out on women is much more straightforward. The preponderance of the evidence renders the conclusion that women are not adversely affected. One reason women might be expected to be more heavily

TABLE 24

The Impact of Contracting Out on Minorities in Los Angeles County

	Black	Hispanic	White
Number of Affected Employees	791	293	174
Percent of Total Affected Employees	63%	23%	14%
Number of Employees Laid-Off	17	17	1
Percent of Total Laid-Off Employees	49%	49%	2%

TABLE 25

The Impact of Federal Contracting Out, by Sex

Total Federal Workforce		Employees Affected		Obtained Other Government Job		Employed by Contractor		Involuntarily Separated	
	%	Number	(%)	Number	(%)	Number	(%)	Number	(%)
Male	**59**	**1,910**	**(75)**	**1,437**	**(76)**	**111**	**(65)**	**71**	**(55)**
Female	**41**	**625**	**(25)**	**444**	**(24)**	**60**	**(35)**	**58**	**(45)**

impacted by contracting out than men is that the government workforce is composed of a greater percentage of women than the private sector workforce. However, women who work in government are less likely to be employed in service occupations than men; therefore, women are far less likely to be affected by alternative service delivery approaches.

Dantico and Jurik (1987) conclude that women are heavily dependent on the government for employment opportunities, especially women in professional occupations. In 1980 the public sector employed 21 percent of all women, but only 16 percent of all white males. In the professional occupations, 50 percent of all female professionals work for the government; only 35 percent of all male professionals do.

Thurow (1982) found that females earn higher salaries in the public sector than the private sector. White women with equal skill levels earn about 20 percent more when they work for the government than when they work in the private sector, while minority women receive about 30 percent higher salaries in the public sector than in the private sector. At best, this is only at indirect evidence that women's career opportunities and earnings potential may be stunted by alternative delivery approaches, such as contracting out.

Women's job opportunities would only be jeopardized by contracting out, however, if they were affected in proportion to their employment in government. The only reliable data shedding light on this issue come from surveys of government workers performed by the GAO (1985). The survey results (shown in Table 25) indicate that although women constitute 41 percent of the federal workforce, only 25 percent of the 2,535 workers affected by the service contracts studied were women. On the other hand, the data reveal that women were slightly more prone to be laid off than men from federal contracting out.

One reason why women in the federal workforce are less prone to be affected by contracting out than men is that only a small portion of women who work for the government are in blue collar occupations, as displayed in Table 26, according to data from the U.S. Statistical Abstract. Though some white collar jobs, such as data processing, are sometimes contracted out, most service jobs that are converted to contract are classified as blue collar. Gordon (1984) found that blue collar jobs are much more likely to be contracted out than white collar positions.[2]

TABLE 26

Percentage of Federal Workers in Blue Collar And White Collar Jobs, by Sex, 1987

	Total Federal Workforce	Federal Blue Collar Workforce	Federal White Collar Workforce
Males	**59%**	**87%**	**53%**
Females	**41%**	**13%**	**47%**

On the local level the only available evidence indicates that the impact of contracting out on women is equally benign. In Los Angeles County, for example, women comprised only 41 percent of all employees affected by government contracts, and only 20 percent of those laid off as a result of contracting out (see Table 27).

[2]Gordon surveyed officials from hundreds of U.S. cities and counties, and also conducted dozens of field interviews. He concluded that "local governments are much more prone to contract out support services of a blue-collar nature than they are to contract out support services of a clerical or quasi-professional (i.e., white collar) nature." The federal experience has been quite similar.

TABLE 27

The Impact of Los Angeles County Contracting Out on Women

	Male	Female
Number of Employees Affected	**791**	**529**
Percent of Employees Affected	**59%**	**41%**
Number of Employees Laid-off	**28**	**7**
Percent of Employees Laid-off	**80%**	**20%**

In sum, no comprehensive study has examined the effect of contracting out on women. Although a large percentage of women in the labor force work for the government, particularly women in professional positions, there is no evidence that the impact of contracting out affects them disproportionately. Indeed, the only available evidence refutes this contention, because women who work for the government tend to be in occupations that are not commonly contracted out.

Issue 7. The Overall Labor Market Impact of Contracting Out

■ All of the studies mentioned above analyze the **direct** employment consequences of contracting out government services. We have compared the number of jobs lost in the government sector with the number of jobs created by private contractors. Typically the private contractor employs fewer workers than the government to perform the same service. This implies that contracting out leads to a loss of jobs in the economy.

Yet a full assessment of the employment impact of this type of privatization requires an examination of the secondary labor market effects of contracting out. While there may be small net job losses in the service area contracted out, the cost savings from contracting out surely create additional employment opportunities elsewhere in the economy. For instance, if a community saves $50,000 a year by contracting out its garbage collection, then the community can either use these savings to expand other services, creating public sector employment opportunities, or it can reduce taxes by $50,000, thus putting more money in the hands of residents, which will eventually be spent on goods or services employing private sector workers.

Unfortunately, there is only one study on the economic impact of contracting out that estimates these vital secondary labor market effects. That study, commissioned by the U.S. Urban Mass Transit Administration and conducted by Charles Rivers Associates (1986), examines the employment implications of competition in local transit services. The study first assumed cost savings of 20 percent—a conservative estimate—by competitively bidding municipal transit services. It then examined two scenarios, which the report explains as follows:

> In the first scenario (dubbed the "constant amount of service" scenario), these cost savings represent reduced requirements for state and local subsidies to produce the same service. Taxpayers in the region benefit from the reduction in taxes devoted to transit. . . . Bus transit jobs would decrease, but this loss would be compensated by gains in other industries. Some regions would lose jobs while others would gain.
>
> The second scenario (the "constant operating budget" case) assumes that all of the cost savings from competitive contracting would be used to expand bus services, thereby creating new jobs.

Using the constant amount of services scenario the study concluded: "The reduced employment in the transit industry is approximately balanced by the employment gains implied by increased consumer spending." More specifically, the study concluded that if competitive contracting for bus service were adopted nation-wide, there would be only a very slight reduction in jobs if all of the savings were passed back to taxpayers: for every $2 million saved, one job would be lost nationwide.

Under the constant operating budget scenario, which implies an expansion of bus service following contracting out, the study found a small but positive net expansion in the total number of jobs in the economy. Based on FY 1983 employment data in the bus industry, the net gain in jobs was projected to be between 1 and 6 percent of total transit employment.

Although the overall labor market effects from contracting out a municipal service have a neutral or positive impact on the total number of jobs created nationwide, local officials who are contemplating contracting out services may be more interested in how contracting out affects the number of jobs available in their own jurisdiction. The Charles Rivers study estimated that contracting out may lead to small employment losses in the community that contracts out the service. This is be-

cause the jobs lost from contracting are those of local transit workers, while some of the jobs gained through increased local taxpayer purchasing power are located in other regions.

Conclusions

■ This review of the academic and technical literature on the employment effects of contracting out yields the following tentative conclusions:

1) Historical studies of the subsequent employment status of workers affected by contracting out have found that only between 5 percent and 10 percent of affected workers were involuntarily laid-off from their government jobs.

2) On the federal level, public assistance payments to government employees who become unemployed due to a service contract are less than 0.5 percent of the contract savings to the government. These "hidden" costs to the government are so small that they would rarely offset the financial advantage of contracting out.

3) The new jobs created by private contractors awarded government service contracts generally pay lower wages than the comparable government positions that were eliminated. The wage disparity, however, differs widely from service to service. For some services, the private sector workers' salaries were only half those of the public sector. For other services, the private sector offered higher salaries.

4) Worker fringe benefits are higher in government than they are with private contractors in almost all the cases studied. Most of the available evidence indicates that less generous fringe benefits is a major source of cost savings for the private contractor vis-a-vis the government agency. In particular, retirement benefits offered by private contractors generally are substantially lower than those in the public sector.

5) One of the primary means by which private contractors reduce costs is by increasing labor productivity. For instance, private contractors have been observed to make greater use of incentive-pay systems, they experience lower rates of absenteeism, they are more flexible in hiring and firing workers, and they make greater use of part-time and multi-skilled workers than does the government. Hence, the reduced labor costs generated by contractors is not attributable solely to hiring fewer workers and paying them less, as is commonly asserted. Much of the reduced labor bill of private vendors is due to increasing the efficiency of labor. Research is needed to measure how much more productive the labor force of private contractors is, on average, and how important this increased productivity is to lower overall costs.

6) Contracting out is not inherently harmful to minorities. In percentage terms minorities are affected by service contracts to a greater extent than whites, but this is mainly because these groups constitute a larger share of the public workforce. The percentage of private sector contractor jobs filled by minorities, however, tends to mirror the percentage of minorities performing the same service within government, according to the most comprehensive study on the subject. The wages, however, are generally lower in these private sector jobs.

Men are more likely to be impacted by government contracts than women, even accounting for the fact that women are more highly represented in the government workforce than in the private sector workforce. The primary reason that women are less affected than men by service contracts is that only a small percentage of women who work for the government are in blue collar positions that are most amenable to contracting.

7) Economic theory suggests that the cost savings associated with service contracting create additional employment opportunities elsewhere in the economy. Unfortunately, only one study has examined the secondary labor market effects of contracting out services. This study of transit contracting found that by taking into account the overall economic impact of contracting out—specifically how the cost savings are filtered back through the economy—at least as many new jobs in the private sector, or in other areas of the government, are created as are lost in the government agency contracting out the service. More research is needed in this area, however to quantify the secondary job impact.

SECTION IV

Summary Reports on Privatization and Employment Policy

■ In August and September, 1987 we conducted telephone and personal interviews with officials involved in the contracting out process in seventeen city and county governments. We selected cities and counties that have very active contracting out programs or programs that have unique features.[1]

There were four objectives of these interviews:

1) We obtained from these jurisdictions whatever data were available on job displacement of government workers resulting from contracting out service delivery. Where available, we also assembled data on how many employees obtained jobs with the contractors and how many were transferred to other government jobs. A summary of the employment data we were able to obtain is shown in Table 28.

2) We asked these local officials to provide us with details pertaining to the contracting out employment policy in their cities or counties. Our objective was to determine whether cities and counties typically have formal employment policies to protect the rights of the affected government workers, as the federal government does under OMB Circular A–76.

3) We questioned the local officials as to how much labor opposition they encountered when they contracted out services. Our goal was to determine which cities were most successful at minimizing employee resistance to contracting, and why.

4) Finally, we examined the benefits and pitfalls that these local governments' experienced in contracting out these services.

Summary Report #1
Fort Worth, Texas

Interviews with Charles Boswell, City Budget Director
Charles Shaparo, Director of Personnel

■ Fort Worth contracts out two major services: solid waste disposal and janitorial services. Together these contracts have a total price tag of over $5 million. Unfortunately, the city was unable to provide us with any specific numbers concerning worker lay-offs. According to Charles Boswell, the city does not have a formal contracting out employment policy. With both of these contracts, however, the city negotiated an agreement with the city workforce that there would be no layoffs. According to Charles Shaparo, the city was successful at "keeping lay-off levels low." Most of the affected workers were transferred to other government jobs.

Summary Report #2
Los Angeles County, California

Interviewed: Michael D. Antonovich, member of the Board of Supervisors, Los Angeles County

(Most of the details in this section come from two sources. The first is a speech given by Michael Antonovich, at the Heritage Foundation, June, 1987. Most of the statistics in this section are from: Los Angeles County Economy and Efficiency

[1]Because this was not a random sample of cities and counties, it may not be valid to make conclusions about **all** local contracting based upon the experiences of the seventeen cities studied.

TABLE 28

Job Displacement Resulting From Contracting Out in U.S. Cities and Counties

City/ County	Service	Year	# of affected Workers	Transferred to Another Gov't Job	Took Job w/ Contractor	Laid-off Or Quit	% Laid-off Or Quit
Los Angeles County, California	Parking Garage	1982	90	N.A.	N.A.	32	35%
	Hospital Laundry	1983	142	N.A.	N.A.	0	0%
	Hospital Custodial	1983	25	N.A.	N.A.	0	0%
	Food Service	1984	33	33	0	0	0%
Phoenix, Arizona	Sanitation	1981	96	N.A.	N.A.	2	2%
	Custodial Services	1977	40	40	0	0	0%
Newark, New Jersey	Sanitation	1982	195	0	195	0	0%
Scottsdale, Arizona	Custodial Services	1982	10	N.A.	N.A.	0	0%
Fort Wayne, Indiana	Street Light Maintenance	1975	75	4	71	0	0%
	Solid Waste	1980	35	N.A.	N.A.	0	0%
Gainesville, Florida	Fleet Maintenance	1979	12	0	12	0	0%
Des Moines, Iowa	Fleet Maintenance	1984	73	34	39	0	0%
	Parking Garage	1984	25	0	25	0	0%
Louisville, Kentucky	Parking Garage	1980	25	0	25	0	0%
New Orleans, Louisiana	Sanitation	1987	225	0	50	175	77%
Inkster, Michigan	Garbage Collection	1965	35	0	35	0	0%
Bay County, Florida	Jail Operations	1985	75	N.A.	70	0	0%
Santa Fe County, New Mexico	Jail Operations	1986	58	2	38	18	31%
Imperial Beach, California	Refuse Collection	1981	10	0	7	3	30%
	Police Department	1983	14	0	7	7	50%
Hamilton County, Tennessee	Penal Farm	1984	60	1	58	1	1%
Atlantic County, New Jersey	Juvenile Delinquency Center	1984	10	3	6	1	10%

Note: An employee was classified as "Laid Off or Quit" if he/she was not offered a job by the government, and he/she did not go to work for the contractor. This does not imply that the worker became unemployed.

Also, the figures in this table are only estimates that were supplied to us by the cities and counties.

Commission, "Report on Contracting Policy in Los Angeles County Government," August, 1987.)

■ Los Angeles County has the largest contracting out program of any jurisdiction in the country other than the federal government. It contracts out over $800 million, or about 20 percent, of its $4.2 billion operating budget. The County estimates its annual savings from contracting out to be $133

million. This is an average service cost reduction of 36 percent from contracting out. Over 600 contracts have been issued since 1980.

We investigated the County's "Proposition A" contracting out program. Proposition A authorizes officials to contract out services that were formerly performed by employees of the County. This program is distinct from the County's contracting of services for which in-house provision is illegal or infeasible. (The initiative was born in 1978 when it was approved by 66 percent of County voters.) Proposition A is a sizeable program: in 1985 these contracts totaled $47 million, with savings of $24 million.

Most of the County's Proposition A contracts are for routine commercial services readily available in the private sector. According to a County review of the program: "Eighty-four percent of the work contracted consists of such internal services as custodial work in County buildings, laundry and food services, grounds maintenance, data entry, and security guards." The majority of the government jobs eliminated by contracting out in these areas paid wages of less than $2,000 a month.

The County has maintained detailed records of the subsequent job experiences of government workers displaced as a result of Proposition A contracting. A total of 1,320 workers since 1982 have been impacted by these contracts. About 80 percent of these workers were transferred to other positions within the County government; about 10 percent went to work for the contractors, about 7 percent left the County government voluntarily, and about 3 percent of the workers were laid off. Of the three percent laid off, two percent went back to work for the County within three years. A 1987 County Commission on the contracting out program praised the avoidance of lay-offs, concluding that the "employee impact has been minimal."

Generally, the wages paid by contractors fall below the wage rates paid by the County government; and this is one major source of saving from contracting out. For some contracts, such as food service, however, contractor wages and benefits were found to be equal to, or better than, those offered by the county.

Los Angeles County's impressive achievement of avoiding lay-offs despite the magnitude of the contracting out program, is in large part attributable to its innovative employment policy for workers affected by contracting out. The County has adopted a formal employee-treatment strategy that is far more innovative than that of any other city or county we examined. Among its key features:

- A de facto no lay-off policy for permanent County employees affected by a service contract.
- Encouraging contractors to offer affected County employees the "right of first refusal" for job openings resulting from the contract.
- A policy that in the event the County employee rejects a job with the contractor, or is not offered a job with the contractor, the County is obliged to "find an internal vacancy for the employee to fill." The labor force is then reduced through normal attrition.
- A requirement by the County Board of Supervisors that 5 percent of the savings from contracting out must be set aside for retraining employees whose positions have been eliminated due to contracting out.

The cornerstone of the Los Angeles County contracting program is an assurance that all affected workers will be provided alternative jobs with the government, and then decreasing the size of the government through attrition. Although this policy worked well during the early stages of the County's contracting out efforts, there are now indications that moving affected workers to other County jobs no longer results in cost savings, because the County workforce is not shrinking. As the County Commission reported in 1987:

> The Board of Supervisors, the public, and County managers must recognize that achieving real cost savings through Proposition A contracting means that current employees must leave County service. . . .
>
> The County's work force and the proportion of the County budget spent on salaries and benefits of employees have increased since 1978 [the year Proposition A was passed]. Attrition is too slow. . . . Reassignment of personnel to County jobs which could themselves be contracted does not reduce the work force. In addition it creates barriers to further contracting. To achieve savings using Proposition A contracting, the Board of Supervisors must find effective means to reduce the [County] labor force. . . .

The Commission advised that the policy of reducing the government payroll through attrition is no longer a viable policy approach if the County wants to expand its contracting out program. As alternatives, it has issued the following recommendations:

- The County should provide outplacement service, special termination pay, early retirement incentives, and job training to affected workers. The 5 percent set aside funds from contract cost savings should be used to finance these programs.

- Preference should be given to the bids of private contractors which agree to provide employment to affected workers. This forces the County to explicitly recognize that when a private firm offers to take on displaced government employees, it confers an economic benefit to the County, which ought to be weighed into the selection process.
- Public employees should be permitted and encouraged to form private companies for the purpose of bidding themselves for County contracts. Currently it is illegal for County employees to make a bid.
- To raise in-house employee productivity, the government agencies should compete with private firms for contracts.

These recommendations are now under consideration by the County's five member Board of Supervisors.

Summary Report #3
Phoenix, Arizona

Interviews with: Ronald Jensen, Public Works Director
Marty Martinez, Assistant Public Works Director

■ Phoenix has been named "the most productive city in America," and its unique contracting out program is a reflection of this achievement. Phoenix was the first city or county to require the government agency to compete along-side the private firms when it issues its RFPs (request for proposals). This innovation has been subsequently adopted by several other jurisdictions.

One of the primary benefits of this competitive approach to contracting out is that it stimulates impressive in-house productivity improvements and cost savings. Forcing the city workers to compete has generated cost reductions even in cases where the city agency has submitted the lowest bid.

In 1981, for example, the city converted a portion of the city's garbage collection to contract with a private firm, which had bid below the city public works department. In 1984, the contract expired and was rebid. Ronald Jensen, the Public Works Director, described the attitude of the city employees in preparation for the ensuing competition: "The city staff was out to win the contract back. All potential cost cutting ideas were pursued in great detail as the competitive spirit prevailed. . . . The latest new technology in equipment was reviewed and evaluated with production increases in mind." Competing against five private firms the city public works department came in with an annual price tag almost $1 million below the second place finisher for a total savings to the city of $6 million over the life of the contract.

There are two aspects of this example that are particularly relevant to employment policy. First, many of the sanitation workers started with the Phoenix public works department, moved to the private contractor in 1981 when the private firm won the contract, and then moved back with the government in 1985 when the government won back the contract. Hence, continuity of employment was maintained.

Second, allowing the city to compete directly with the private sector has enhanced employee performance and according to Jensen, "the impact on the morale of the Sanitation Division employees has been tremendous." This observation is of particular interest given the common charge that contracting out adversely affects the public employees' morale.

The experience with garbage collection was not an isolated incident. Phoenix now contracts out 33 services with annual savings of approximately $2 million. Other major services contracted out include street maintenance and custodial services. City officials were only able to supply us with complete employment data for two of the city's contracts. When the city contracted out garbage collection in 1981, 96 employees were affected. Only two of these workers left the city involuntarily; the remainder either took a position with the contractor or were placed elsewhere in the city. In 1978 Phoenix contracted out custodial services impacting between 30 and 50 workers. None of these workers was laid off; most were transferred to the city's aviation department, which was growing rapidly at the time and could easily absorb the additional workers.

The city's contracting out employment policy is protective of worker's rights. According to Marty Martinez, the city's RFPs stipulate that "the successful company must offer new positions to displaced city workers." In addition, the City Council established a policy in 1980 assuring city employees that there would be no lay-offs as a result of contracting out. Thanks to such steps, employee resistance to contracting out in Phoenix has been minimal.

Summary Report #4
Newark, New Jersey

Interviews with: Frank Sudol, Chief of Planning, Dept. of Engineering
Jacob Weiss, Director of Labor Relations

(Some of the information in this section was extracted from: Frank Sudol and Alvin Zach, "The Newark Experience: Is Contracting the Answer?" 1987, unpublished.)

■ Next to Los Angeles County, Newark, New Jersey now has the largest contracting out program of any city or county in the United States. Its public works department spends over $25 million each year on contracts for services that at one time were supplied in-house. The city currently has 19 public works service contracts for such functions as solid waste collection, tree removal, street sweeping, and computer data entry.

The city has adopted an approach to contracting out that is in some ways similar to that of Phoenix, in that the cornerstone of the initiative is "to promote competition." The city typically contracts out only a portion of the service and retains an in-house capability for the remaining portion. For instance, the city contracts out 60 percent of its sewer cleaning, 50 percent of its data entry operations, and 75 percent of its engineering design. The advantage of this partial contracting approach, states a city report, is that it creates "a heightened awareness among private sector contractors and public sector employees of the competitive nature of the task."

Cost savings from contracting out have in some cases been dramatic. For example, the city recently hired an independent consultant to conduct an extensive cost and performance comparison between in-house and contracted solid waste collection. The consultant concluded that contracting out a segment of the city's solid waste collection has saved the city over $900,000 over three years. The cost of municipal collection was $47.77 per ton, while the cost of private collection was $39.43 per ton, or 21 percent lower. These cost savings were attributed to several factors, three of which were labor-related:

- The employees of the private contractors were more productive. The private employees collected 5.7 tons per-person, per-day versus 3.2 for the government employees.
- The contractor's employees were younger and "moved more quickly." The contractor's crews collected 5.9 containers per minute while the Sanitation Department crews collected 3.6 per minute.
- The contractor could "more easily discipline ineffective or inefficient employees."

The competitive aspect of these contracts now appears to be yielding positive results for the city. The consultant has noted that despite large initial cost savings from solid waste contracting, "The price gap between City crews and the contractor has narrowed. City crews have become more productive."

There were 195 city sanitation workers affected by this garbage collection contract. All of these city positions were terminated. However, as a condition of the contract the winning firm "agreed to take on all workers the city laid off," notes Jacob Weiss, Director of Labor Relations for the city. The contract did not specify a minimum length of time that the private firm would have to employ these workers, but simply mandated that the contractor "give the workers an opportunity to perform."

According to Weiss, "the wages offered by the private sector were substantially higher than the wages paid by the Newark Sanitation Department." However, compared with that of the city, the contractor's fringe benefit package was far less generous; for instance, it offered no health care benefits.

In general, fringe benefits is a major area where Newark reduces in-house costs by contracting out. Fringe benefits in 1985 accounted for 40 percent of the city's payroll. According to a report by the Newark Engineering Department, "Private employees, even those with generous salaries, rarely receive equivalent benefits."

Frank Sudol states that despite that the city employees are unionized, "Public sector union opposition to contracting has not been overwhelming." This is apparently attributable to two features of the city's contracting out initiatives. First, there has been no problem to date in moving affected workers to other city jobs that open up through normal attrition. Second, the city has adopted a "phase-in" approach to contracting out. Sudol maintains that this gradual contracting out policy has avoided "the type of shock-treatment" that invites public employee resistance to privatization.

Summary Report #5
Scottsdale, Arizona

Interview with: Tom Davis, Assistant City Manager

■ Over the last ten years, Scottsdale has contracted out up to 40 percent of its municipal budget, including contracts for park maintenance, custodial services, health services, and some parts of its mass transportation system. It was also the first city in the nation to contract out fire fighting service. This aggressive contracting out policy has resulted in a reduction of the municipal work force from a high of 100 employees per 10,000 population down to 76 in 1983. Projections are that that number will decline to 71 workers per 10,000 residents by 1989.

When Scottsdale contracted out custodial and mowing services in the early 1980s, all of the twelve affected workers were moved to other city jobs, which had opened up due to normal attrition. According to Tom Davis, assistant city manager, the city has adopted an informal but "highly visible" no lay-off policy when it contracts out a service. Consequently Davis states that there has been "no employee resistance to contracting out in Scottsdale."

Summary Report #6
Imperial Beach, California

Interview with: Sherman Stenburg, City Manager

■ Imperial Beach began relying heavily on contracting out to cut city costs in the late 1970s literally as a matter of economic survival. According to Sherman Stenburg, the city manager, the loss of tax revenues due to California's passage of Proposition 13 in 1978 had "brought the city to the point of bankruptcy. Contracting out was an attempt to keep the city afloat." The figures back-up this assessment: in 1981 the city had a $6 million budget with only a $6,000 reserve fund. The city had almost no funds to absorb the cost of even a minor budget contingency.

Imperial Beach now contracts out a long list of services including law enforcement, refuse collection, ambulance service, park maintenance, recreational activities, payroll preparation, and accounting. The city work force has been reduced accordingly. In 1980 the city had 101 employees; it now has between 30 and 40.

Imperial City is one of the few cities or counties we examined that has experienced heavy lay-offs as a result of contracting out. Examples:

- When refuse collection was contracted out 3 of 10 workers were laid off.
- Contracting out police service resulted in 7 of 14 workers being laid-off and the remaining 7 taking a job with the contractor.
- The city's park maintenance contract led to all 5 impacted workers being laid-off.

The city's employment policy was not very protective of workers affected by contracting out. Lay-offs were made in conformance with the public employee union's collective bargaining agreement, which established bumping rights based upon seniority. The city established a reinstatement policy also based upon seniority. In addition, the city was not in a position to move affected workers to other government jobs, because the purpose of the contracting out strategy was to immediately reduce the city's budget, and moving affected workers to other government jobs would have delayed savings.

One of the major sources of savings from these contracts arose from reductions in the city's cost of providing fringe benefits. According to Stenburg, "The city's fringe benefits had gotten out of line with the private sector." The private providers who took over provision of government services generally offered less generous fringe benefits. The salaries paid to the employees of the private contractors, however, were comparable.

Understandably, the city encountered "considerable union opposition" to its contracting out program, but according to Stenburg, "in most cases economic arguments prevailed." Only with the contracting of law enforcement was union opposition an impediment to contracting out—but although it slowed the process, it did not prevent it from taking place.

With the city's economic crisis now well behind it, we inquired whether there are plans to transfer services back in-house. We were told that to date no such movement has developed. Two reasons were given. First, the cost savings to the city from contracting out are now well-documented and substantial. Second, Stenburg indicates that "contractors are doing a good or excellent job at delivering services."

Summary Report #7
La Mirada, California

Interviewed: Robert C. Dominguez, Assistant City Manager

(Some of the statistics in this section were taken from: C. David Peters, City Councilman, "Contracting for Services: The La Mirada Experience," no date.)

■ La Mirada, California has relied heavily on contracting out from the day the city was incorporated in 1960. One of the reasons the city incorporated independently was to bring down tax rates and reduce the cost of government services; hence the pressure to contract out was immediately present. According to Robert Dominguez, assistant city manager, "During incorporation, the newly-elected City Council went on record and adopted a policy that essentially said the city would retain a small work force and emphasize contracting whenever possible."

This philosophy continues to prevail today. Almost every commercial municipal service is contracted out. The city currently has 64 service contracts. It hires only 75 full time employees for a population of over 40,000.

The city does not have a formal contracting out employment policy, however. Most of La Mirada's services have always been contracted out, so in most cases there is no existing labor force to displace. The city's policy, states City Councilman David Peters, "has been that the quality of service is most important to the residents, regardless of **who** provides it." Peters lists several advantages to the city of contracting out services that are related to employment:

- City personnel costs are kept very low.
- Contractors are "easier to control than city employees."
- City managers are "more objective with a contractor than with their own employees."
- The city does not have to deal with unionized government employees, who "today have become a political force, a pressure group in the community."
- Contractors are more flexible than the bureaucracy.
- With a small work force, the city is able to offer high pay and generous benefits to the few employees it does hire, thus attracting high quality workers.

The La Mirada experience suggests that contracting out can be most economical and meets with the least political resistance in young cities or rapidly growing cities that have not yet built up a large in-house service capability. Contracting out for new or expanded services avoids the job displacement issue altogether. In such cases, the decision to contract out or provide services in-house is entirely depoliticized. It can be based purely on quality of service and cost reduction factors, as has been the case in La Mirada for the past 25 years.

Summary Report #8
New Orleans, Louisiana

Interviews with: Jack Belsom, Director of Civil Service
Pat Kolowski, Director of Sanitation

■ New Orleans contracts out two major services, garbage collection and janitorial services. We were able to obtain detailed information about the city's garbage collection contract that was put out for contract for a second time early this year.

The major force behind the decision to contract out garbage collection was to cut down on the costs of city services. The New Orleans economy had been slumping for the past twelve months and according to Jack Belsom, Director of Civil Service, the city has faced "insurmountable budget problems." The city employees resisted this decision to contract out, but ultimately, fiscal considerations left no other option.

Few labor protections were extended to the 225 affected city workers, although the city did retain the administrative staff and stipulated in the contract that the winning contractor—American Waste—must offer employees the right of first refusal for any new job openings. American Waste had 110 job openings, and 50 of the affected workers applied and were hired. The remaining 175 employees were laid off. A number of these laid-off workers took advantage of the city's early retirement option.

There were special circumstances surrounding this contract that explain why so few employees took jobs with the private contractor. Under city control, the garbage collectors worked a 4 hour shift. Most of the employees either picked up two routes with the city, or held a second job. The jobs available with American Waste involved an eight hour shift. So many of the affected workers who were "laid-off" in fact were not rendered unemployed, but simply preferred to work at their second jobs.

The salaries and benefits offered to the workers who joined the contractor were "substantially higher with the private sector," according to Pat Kolowski, director of sanitation. Wages, for example, were about 20 percent to 25 percent higher with American Waste.

An interesting development with this contract was that the unions actually worked with the city to get the contract issued, even though the private contractor would be employing fewer workers. We were told that the reason for the union support of this contract was that while only about 30 percent of the city's garbage collectors were unionized, private sector garbage collection in the city is a union shop, with 100 percent of the employees in the union. Contracting out, therefore, strengthened the private union while adversely affecting many former city sanitation employees.

This year New Orleans has tried to contract out its emergency medical services, but fierce employee protests have so far blocked the initiative. The large scale lay-offs experienced with previous city contracts, such as with the garbage collection contract, have created an extremely hostile climate to contracting out among the city's work force. The lesson here is that if contracting out takes place without regard to the fears and concerns of the affected workers, subsequent contracting efforts may be stifled by a resistant public employee union.

Summary Report #9
Fort Wayne, Indiana

Interview with: Carl O'Neal, Director of Transportation

■ Fort Wayne contracts out for solid waste disposal and street light maintenance. The street light maintenance contract was issued in 1975 and affected 75 workers. The union contract prohibited worker lay-offs. Consequently, Indiana and Michigan, the private contractor, agreed as a condition of the contract to hire 71 of these workers; the remaining 4 were transferred to other government agencies.

Solid waste disposal was contracted out in 1980 by splitting the city into two zones and issuing a separate contract for each. The idea behind hiring two contractors, says Carl O'Neal, the city's director of transportation, was to "make the two firms competitive." A total of 35 city workers were displaced by the contracts, but there were no lay-offs; most of the workers were moved to other positions inside the city government. Finding employment for these workers was handled with relative ease, because Fort Wayne has the fastest growing population of any city of its size in the nation, and the municipal government labor force has grown accordingly.

This case study suggests that contracting out can be a particularly attractive option for expanding cities. When the city labor force is expanding, transferring affected workers to other government positions can be handled with minimal labor tension and only slight added expense to the city.

Summary Report #10
Indianapolis, Indiana

Interview with: Donald McPherson, Director of Administration

■ Indianapolis contracts out several commercial services, including such activities as vehicle maintenance and janitorial services. For the most part the city has limited its contracting out activities to services that have traditionally been provided by private firms, or to in-house services that need to be expanded. Unfortunately, the city was unable to supply us with any employment data. According to Donald McPherson, the Director of Administration, the city does not have a formal employment treatment policy for workers who are affected by contracting, but has instead "an unwritten no lay-off policy." The city is also required in its collective bargaining agreements to notify the unions in advance when a service is to be contracted out.

Summary Report #11
Gainesville, Florida

Interview with: Pete Snyder, Director of Human Resources

■ Gainesville has successfully contracted out a wide range of municipal services, including fire fighting, garbage collection, fleet maintenance, janitorial services, engineering services, and employee training.

We were able to obtain employment data for one of these contracts: automobile and truck maintenance. Gainesville contracted out fleet maintenance in 1979 to ARA Services Inc., resulting in the displacement of 13 government mechanics. All of these workers took jobs with the

contractor. The contract required only that ARA retain these workers for a minimum of thirty days, and most of them eventually rejoined the city work force to perform different jobs. Yet no workers were laid off as result of the contract. Pete Snyder, Director of Human Resources, told us that the city's philosophy is to "find displaced workers jobs with the government rather than turn them onto the streets."

The contract with ARA has saved the county an estimated $200,000. These savings are largely attributable to improved preventative maintenance and fewer repeated repairs. The success of this contract has attracted wide interest, including features in *Time* magazine, and the *Wall Street Journal*.

Gainesville's official contracting out employment policy is now written into the language of its union employment contracts. This policy explicitly establishes the management's right to contract out services, while the city promises to "be responsive to the affected workers" and notify the unions in advance of any management plans to issue new service contracts.

Summary Report #12
Des Moines, Iowa

Interview with: Sy Carney, City Manager

■ Des Moines, Iowa has contracted out two services—fleet maintenance and parking garages—that were formerly handled by government employees. Both of these contracts have been recognized as models of success.

When city officials announced in 1984 their intention to contract out fleet maintenance they encountered what city manager Sy Carney describes as "a lot of employee resistance." Seventy-three employees were in jeopardy of losing their jobs, and as Carney tells the story, their opposition was so intense that "the only way we could issue the contract was by establishing a no lay-off policy." Of the 73 affected workers, 39 eventually accepted jobs with the contractor, and the remaining employees were transferred to other city jobs. For the workers who went to work with the winning private firm, salaries and benefit levels were raised by between 10 percent and 20 percent above their government compensation, estimates Carney.

This is the largest fleet maintenance contract in the country and it has been so successful that several other cities have studied the situation in Des Moines and subsequently contracted out the service in their cities. The contract saves the city $450,000 per year. Moreover, according to Carney, the private contractor has "outstanding preventative maintenance" procedures that both cut down on repair costs and reduce the down time of the city's vehicles. The contractor's procedures are highly automated, requiring fewer employees. Carney concludes, "the quality of the service is better than under government operations."

The city experienced similar success in contracting out its parking garage operations in 1984. Twenty-five parking attendants were affected by this contract; all of them went to work for the private vendor as a condition of the contract. Today, the contractor employs 15 attendants; we were not able to find out the employment history of the other ten employees. Carney believes that the wages of these workers were "comparable to their government salaries." The contract saves the city $150,000 annually.

This case study clearly demonstrates the importance of establishing a no lay-off clause when a city contemplates contracting out a service. Before this policy was adopted by the city, union resistance effectively blocked the contract. But by assuring workers that their jobs were not at risk, contract deliberations went smoothly, to the benefit of the city, the contractors, and the workers.

Summary Report #13
Santa Fe County, New Mexico

Interview with: Pete Garcia, Finance Director

■ In 1986, Santa Fe became one of the first cities or counties in the U.S. to contract out its jail to a private company—Corrections Corporation of America (CCA). A total of 58 workers were displaced by the contract. To preempt opposition to the contract, the county insisted as a term of the bid proposal that the winning private firm must hire all current employees of the county. Before the issue of job security was settled, county employees had put up enormous resistance to the privatization idea. Once agreement was reached, opposition was significantly reduced. According to one of the county jail employees, quoted in the Santa Fe *New Mexican* shortly after the terms of the contract were determined, "Basically the worst is over. The real issue was our jobs and I think we have them."

All the 58 workers were offered jobs with CCA; about two-thirds accepted. A few remained in

other jobs with the county, while the remainder sought jobs elsewhere in the private sector. The pay scales of the CCA were "comparable to the county pay rates," according to County Finance Director Pete Garcia.

The benefits package that CCA offered was more generous than the county's. CCA promised to assume the employee's accrued vacation, offered dental and disability benefits that were superior to the county's, gave 10 paid holidays, 12 days of annual leave, and 12 sick days. The employees also were offered the chance to participate in an Employee Stock Ownership Plan (ESOP).

Pete Garcia's overall assessment of the contract is that "performance has been very favorable. Operations are more professional now." The contract will save the city $1.2 million over 3 years.

Summary Report #14
Louisville, Kentucky

Interview with: Dan Dues, Assistant Director of Public Works

■ Louisville has contracted out its parking garage operations since 1980. Dan Dues, the Assistant Director of Public Works recalls that the 25 city attendants put up "some resistance to the contract due to the uncertainty as to what would happen with their jobs." To overcome the unionized workers' fears, the city included a bid specification that required the private contractor to hire all displaced workers and "provide the same level of benefits." The private contractor was legally mandated to employ these workers for a minimum of six months. Initially, all 25 workers joined the private contractor workforce; unfortunately, the city had no information as to how long they stayed in these private sector jobs.

The motivation behind these comprehensive labor protection clauses was that the Public Works Department "wanted to avert potential contracting out labor problems down the road," says Dan Dues.

Summary Report #15
Inkster, Michigan

Interviewed: John Bloodworth, Public Works Director

■ Twenty years ago, Inkster, Michigan (population 40,000) abandoned its in-house garbage collection capability and contracted out the service to a private trash hauler. At the time, Inkster had a sanitation work force of 35 employees. As a term of the contract, the private vendor agreed to hire all 35 workers. An interesting additional requirement of the contract was that the contractor had to purchase the city's garbage trucks.

According to Public Works Director, John Bloodworth, "at the time the contract was met with much employee opposition." But Bloodworth feels that the employees fared better in the private sector. The workers made the same base salary but were put on an incentive pay system, which allowed them to accrue sizeable bonuses. In addition, the typical private garbage collector works a six hour day, versus 8 hours when the city provided the service. The original contract resulted in "substantial savings" for the city, and has been renewed several times.

Summary Report #16
Hamilton County, Tennessee

Interviewed: "Flop" Fuller, Director of Corrections

(Some of the details in this section come from: Charles Logan, *Proprietary Prisons*, unpublished manuscript, National Institute of Justice, 1987.)

■ In 1984, Hamilton County contracted out its medium-security penal farm—the Silverdale Detention Center—to Corrections Corporation of America. Of the 60 affected county employees, all were hired by CCA, except for one employee who left the area and one who remained with the county government. All of the workers who went to work for CCA received a pay increase, were enrolled into an employee stock ownership plan, and received comparable fringe benefits to those provided by the County. The pension benefits offered by the private contractor, however, were lower than those offered by the county.

According to Flop Fuller, the County Director of Corrections and the individual responsible for monitoring the contractor's performance, "about 95 percent of the employees were opposed to privatization." As required by the contract, CCA offered jobs to the 60 affected county workers. However, within two years, thirty of the workers had left—20 of whom found better jobs, and 10 of whom were terminated. CCA now has a staff of 80 working at the detention center. This employment increase is due in part to the growth in the prison population.

Despite the hardships encountered by some of the employees, the contract has worked out well for the county. Prior to privatization, it had cost the county approximately $25 per-inmate per-day to operate the center. Corrections Corporation charges about $21 per day. In the first year, the company implemented 74 cost-cutting innovations at the detention center. In addition, CCA has financed $1 million worth of renovations to the facility, even though it is still owned by the county.

Summary Report #17
Atlantic County, New Jersey

Interviews with: Glen Mawdy, Deputy County Commissioner
Tom McGardle, Project Manager, RCA Services Co.

■ In 1984, Atlantic County contracted out its juvenile delinquency center to RCA Services Company. From the beginning, the county adopted an employee-treatment strategy that was extremely favorable to the workers. One of the conditions of the contract was that any of the 10 unionized employees who were displaced would be made an offer to work for the private contractor. As Glen Mawdy, Deputy County Commissioner tells the story, "We sat down and met with the employees, kept them informed, and assured them that none of them would lose their jobs." As a consequence, "there was not much opposition by the employees. In fact they were pretty receptive."

Aside from the fact that the city management communicated closely with the city workers throughout the contracting process, a second reason the employees were receptive to the initiative was that the center was not being run well by the county. RCA enlarged the operations of the center, and assured the employees who went to work for them that they would not suffer a pay reduction—many, in fact, received a pay raise. According to RCA representative Tom McGardle, the only feature of private employment that was less attractive to workers was that "benefits were reduced." The county offered more generous health benefits, retirement plans, and dental coverage.

Glen Mawdy states, "For the most part the contract went well." Cost savings were substantial; by hiring RCA, "the county knocked $500,000 out of its annual budget." Unfortunately, two years after the contract was issued, the New Jersey State Attorney General ruled that the county could not legally contract out this aspect of corrections. The contract was, therefore, terminated and the service was moved back in-house. Most of the RCA workers transferred back to the county government.

Discussion

■ These summary reports shed some additional light on many of the issues raised in the literature outlined in Section III. For instance, our discussions with public officials from these seventeen cities and counties supported our earlier assumptions that local governments contract out primarily to save money. In all but a few cases, the cities and counties realized the savings that were projected. In most cases, the service performance was rated equal, or superior, to the quality that residents had received under government operations.

Several tentative conclusions can be drawn from the contracting out experiences of these seventeen cities and counties regarding the employment issue:

1) In almost all cases the initial reaction of affected government workers to the contracting out proposal was hostile. Job security was their principal concern.

2) There were few worker lay-offs resulting from contracting out in the majority of the cities and counties we investigated. Most cities established a no lay-off policy as a condition of the contract to protect the job security of their existing work force. In only two of the seventeen cases studied were workers' jobs terminated without the government agency arranging alternative employment opportunities for the displaced workers. In both of these instances, contracting out had been initiated because the city or county was experiencing severe fiscal strain.

3) Most cities do not have formal employment policies, but instead deal with the employment issue on an **ad hoc** basis. Typically, the employment treatment policy was included in the terms of the contract. Only a few cities had established **formal** no lay-off policies.

4) Those cities with the most accommodating contracting out employment treatment strategies generally contracted out the most services and confronted the least political resistance to privatization. In a few cases where cities had laid off workers after contracting out a service, unions' opposition to subsequent efforts to contract out grew more intense. In one instance this height-

ened resistance successfully impeded a city's plan to contract out a service.

5) Most of the cities and counties we contacted do not contract out for the provision of existing in-house service capability, but for expanded or new services. Contracting out these services does not significantly affect the existing work force and thus generates minimal political resistance.

6) It was quite common for the government agencies to require the contractor to offer affected employees the right of first refusal to private sector jobs opening up as a result of the contract. By guaranteeing employees these jobs, worker opposition to contracting out was lessened, although not eliminated.

7) Another common approach to the issue of job security for affected workers was to transfer workers to other government jobs made available through attrition. For most cities this employment strategy worked well. Based upon the observations of the public officials we interviewed, workers preferred this approach to taking a job with the contractor, because it involved less disruption and uncertainty.

8) Reducing the work force through attrition was not a viable strategy for all cities. For instance, Los Angeles County indicated that its contracting out program was so extensive that attrition was insufficient to absorb all of the workers that were affected by contracts. Thus, for cities with an advanced contracting out program in place, reassigning workers could cancel or delay expected savings from additional privatization. Also, if employees are moved to other government commercial functions, efforts to contract out those services may be impeded.

9) In virtually every case for which we could obtain data, the wage rates of contracted employees were higher or equal to the wage rates of the government workers. Contract employees were often placed under an incentive pay system where their wages were based in part on performance.

10) The fringe benefits offered by the private contractors were normally less generous than those offered by government agencies. Health and retirement benefits were commonly mentioned as being higher in the public sector. In some instances, however, the contractor offered better benefits.

11) Where measurements were available, private contract workers had higher productivity levels than their counterparts in the government agencies. This was often cited as a major factor accounting for the reduced costs of the private contractor.

12) In cases where government workers joined the contractor's work force, they often stayed for less than two years. It is not clear whether this was because of dissatisfaction with the contractor, contractor dissatisfaction with them, or because they received better job offers elsewhere. In many instances, the employees eventually returned to the government work force.

13) Stock purchase options and Employee Stock Ownership Plans (ESOPs) proved to be increasingly common forms of compensation offered by private contractors to entice government workers to join their firms. Typically the workers were offered a small number of free shares of the company's stock with the option of buying additional shares at a discount. We were unable to determine whether this was viewed by employees as an attractive inducement to work for the private contractor.

14) Allowing the in-house government agency and its workers to compete side-by-side against private bidders was standard procedure for three of the cities we examined. Officials informed us that one advantage of this approach was that it puts the government work force in a competitive mode, thus stimulating productivity improvements. They also noted that employee resistance to contracting out appeared to decline when the work force recognized it had been given an equal opportunity to compete.

SECTION V

Policy Recommendations

■ The displacement of government employees is probably the most controversial issue associated with the policy of contracting out government services. When this issue is not satisfactorily resolved, it can be a formidable obstacle for jurisdictions that are attempting to privatize government services. Indeed, on numerous occasions attempts to contract out services have been thwarted because of vehement resistance by public employee groups, as discussed in Section I. In most of these cases the public officials had failed to develop an acceptable employee treatment strategy.

Public officials at all levels of government—federal, state, county, and city—have tended to underestimate the importance of the employment-related issues associated with privatization. Because contracting out is primarily driven by the desire to reduce costs, officials have generally focused their attention on the bottom line budget impact of contracting out, giving too little concern to the politics of contracting out. While laying off government workers may make budgetary sense, it can be a serious political mistake that casts a long shadow over future contracting out efforts.

Our overall recommendation, therefore, is that governments confront the employment issue head on by developing formal employment policies for workers affected by contracting out. The employment policy should establish procedures for protecting the job security of all affected government workers. Laying off workers almost always generates enormous opposition to contracting out and should be avoided except for the rare cases where there clearly is no alternative. Establishing a formal employment policy that addresses the fears and concerns of the government workforce, helps to diffuse the initial opposition to contracting out proposals.

Based upon our case studies of seventeen cities and counties, we identified a number of employment treatment strategies that won the approval of the local public employees and thus removed a major impediment to this alternative delivery approach. It appears that each of these strategies can be adopted without sacrificing the budget savings that arise from contracting out.

1) Target new services and major expansions of existing services for contracting out.

■ The majority of the cities and counties we studied concentrated their contracting out efforts on new or expanded services. This policy has two advantages. First, there is no employee impact when a new or expanded service is contracted out. And second, once the government develops an in-house capability and hires a staff to perform a service, government officials are understandably reluctant to contract out the function in the future. Contracting out new services generates significantly less political resistance than contracting out existing services.

For cities with growing populations and increasing demand for government services this strategy is particularly appropriate. The government can provide the service for some residents, and a contractor for others.

2) Whenever possible establish a "no lay-off" contracting out policy.

■ In the seventeen cases we investigated, employee resistance to contracting out was minimal in cities where the government jobs of existing employees were secure. A no lay-off policy is good politics, since it redresses the primary grievance of the public work force. Moreover, it reduces the likelihood of a union rallying the public against contracting out by charging that the policy is insensitive to government workers.

3) Reduce the government work force through attrition rather than lay-offs.

■ Most cities at the forefront of the contracting out movement rely on normal attrition rates to

reduce the public work force, rather than laying off affected workers. This may delay potential cost savings, but by eliminating the worst fear of government workers, the strategy increases the chances that privatization will be a success, thus assuring that the cost savings will ultimately be achieved.

There is strong evidence, in fact, that laying off workers costs the government more than relying on normal attrition to reduce the work force. Greenhalgh (1978) compared the cost savings of a reduction in force of 100 workers in the State of New York achieved through lay-offs, on the one hand, and an attrition policy on the other. When factors such as lost productivity, retraining costs, unemployment insurance chargebacks, lost state income tax revenues, and other costs were taken fully into account, Greenhalgh found that for every $1 million in payroll reductions, the net budget savings under a lay-off strategy was about $400,000, while the net savings under an attrition policy was approximately $500,000. Greenhalgh concluded that "in the average situation, **the lay-off strategy is not cost-effective** as compared with a planned attrition strategy" (emphasis in original).

For most cities with average employee turnover rates, an attrition policy is feasible. Annual attrition rates in government are about 5 percent per year; few jurisdictions contract out 5 percent of their government jobs in a year.

Of course, there are drawbacks to an attrition policy. Most notably the skill requirements of positions that open up through attrition often do not closely match the skills of workers available to be transferred into those openings. Hence, an attrition policy typically involves retraining costs. These factors must be weighed into the decision as to whether to lay off workers, or to move them to other government jobs.

4) Require contractors to offer the right of first refusal to affected government employees for all job openings.

■ Requiring the private contractor to offer the right of first refusal for new job openings assures government employees that they will have a reasonable chance to obtain jobs in the private sector for which they are fully trained. As Table 28 (shown earlier) demonstrates, a large percentage of employees affected by contracting out in the seventeen cities and counties we studied eventually took a job with the private contractor. This policy can also reduce retraining and other transition expenses facing the government.

Most cities requiring private contractors to offer the right of first refusal to displaced government workers have established this policy in addition to, rather than as a substitute for, a no lay-off policy. In these jurisdictions, if a displaced worker declines a job with the contractor he is guaranteed a job with the government.

5) Give priority consideration during the competitive bidding process to firms that agree to hire displaced government workers.

■ By offering to hire the displaced government work force, the contractor removes a substantial cost from the shoulders of the government. The government realizes immediate payroll reductions and it does not have to retrain or reassign the affected workers.

Los Angeles County now has under consideration a policy to reward contractors for promising to hire displaced government workers. During the bidding process, bonus points would be awarded to firms that agree to hire the County employees. This innovation should be adopted by jurisdictions that wish to pursue aggressive contracting programs.

6) Encourage government employees to form private companies to provide government services.

■ Government workers in some cases may be willing and capable of performing their jobs under contract with the agency, rather than as employees of the government. This may result in a "win-win" situation where the city obtains the service at less cost and the employees earn profits from the contract.

The federal government is currently crafting a plan, called Fed Co-Op, which would allow federal workers to form ESOPs and to make bids themselves on federal contracts. As an added incentive for employees to go private, the federal agencies would give the workers a sole source contract for up to 3 years, after which time the contract would be bid under normal competitive

procedures. Another incentive under consideration in the plan is to turn over to the employees at a discounted price the federal agency's capital assets used to perform the service.

On the local level, a number of cities, such as San Francisco, have allowed city employees to provide a service under private contract with the city. Sacramento County, California contracted in 1980 with former government employees to provide park and recreational services. After the first year, the former employees tripled the number of recreational programs and reduced program costs by 57 percent (Cowden, 1982).

Some cities and counties, however, prohibit this practice. These restrictions should be lifted and employees advised how to form their own companies.

7) Protect transferred employees against pay reductions.

■ Displaced employees transferred to other government jobs in many instances are placed into lower grade positions with reduced earnings. To avoid employee discontent arising from this, governments should consider not only a no lay-off policy, but a guarantee to workers that their earnings will not decline, even if they move to lower skilled positions. Several of the cities we interviewed have established a "no pay-cut" policy. In some cases, however, governments may face equal-pay-for-equal-work obstacles to this proposal.

8) Allow the city agency to compete alongside the private sector during the competitive bidding process.

■ The primary motivation for contracting out services in most cities is to save money. And these budgetary saving are attributable mainly to the pressure of competition. Thus, it makes budget sense to allow the government agency to compete for a contract under the same rules as the private firms. If the government agency can outperform the private contractors, it should be awarded the contract. The Phoenix experiment indicates that allowing the government agency to prepare a bid enhances the integrity of the bidding process and can lead to dramatic improvements in the efficiency of the public sector.

Allowing the agency to compete also has had a dramatic impact on reducing government employee opposition to the contracting out process. Employees feel they have been given a fair shot at the contract when the agency competes. Moreover, allowing the government agency to compete has been demonstrated in Phoenix to enhance government productivity. Ronald Jensen, director of public works, insists: "Involvement breeds commitment, and by involving all employees in a team effort, we have been successful in providing the most cost-effective services for the Phoenix taxpayer."

9) Tie management pay levels to productivity improvements and cost reduction to encourage contracting out.

■ In most cities and counties managers have an incentive to engage in bureaucratic empire-building because their pay and prestige is linked to the number of employees they have working beneath them. This incentive structure runs contrary to the objective of contracting out, and is one reason why many managers are unenthusiastic about the strategy. According to former U.S. Department of Labor Secretary William Brock (1987), "Our line managers perceive the A–76 contracting out process as providing a lot of work with little return."

To redress this problem, managers' pay scales should be based upon reductions in the cost of providing the agency's services, either in-house or by the private sector. Both Los Angeles County and Phoenix reward bonuses on the basis of cost reductions due to contracting out. This approach has sparked interest among middle management in promoting the concept.

10) Set aside a percentage of the savings from contracting out for job retraining and placement.

■ The key to reducing the government work force after contracting out a service is to place these workers in jobs in the private sector. A percentage of the savings from contracting out services should be set aside for this purpose. Los Angeles County currently reserves 5 percent of the contracting out savings for a retraining account fund.

11) Offer early retirement benefit packages to workers displaced by contracts.

■ Several cities that we studied have reduced the government work force by offering generous early retirement packages to affected employees. Offering early retirement can often be less expensive for the city than retraining or transferring personnel. We found that offering early retirement to displaced workers was a common practice in the seventeen cities we studied. Los Angeles County funds early retirement incentives out of contracting cost savings, for instance.

12) Reimburse public employees for lost pension benefits as a result of leaving the government.

■ One of the most important ways in which public employees stand to lose when they leave the government to work for a contractor is through forfeited pension benefits. Retirement benefits compose a very large percentage of total labor compensation in most county and municipal governments. This gives service workers a powerful motivation to stay with the government and resist contracting out. One possible solution is to give to employees who leave the government as a result of contracting out an annuity worth the employee's accumulated pension benefits. This annuity could then be cashed in upon retirement.

An alternative would be to make government pension benefits portable, so that service workers could move into the private sector without it affecting their accumulated retirement benefits. The federal government recently revised its public employee pension program to make benefits more portable.

13) Reserve all in-house service job openings for workers displaced due to contracting out.

■ One method of insuring that employees receive jobs that open up through normal attrition is to create an in-house priority placement program, which reserves job openings for displaced workers. For large cities and counties with large labor forces, it may be necessary to create "stopper lists" for service job vacancies in the government. This facilitates the matching of skills of displaced workers with available government job opportunities. The U.S. Department of Defense has implemented this policy for several years; it helps account for its low level of job displacement.

14) Begin planning the privatization process far in advance.

■ The vast majority of the cities we interviewed, that had successful contracting out programs, used a "phase in" approach to contracting out. In Newark, for example, only a portion of the activities eligible for contracting out were selected each year for privatization. The purpose of this "go slow" policy is to avoid a dramatic one-time shift in service provision from the public to the private sector, which might lead to vehement protests from unions and elected officials.

This strategy allows the government agency to plan well in advance the services that it will target for contracting out. This also means that public officials can prepare for the transfer of employees of contracted positions to other similar service occupations, and avoid hiring new workers for services primed for contracting out. Prudent planning of this kind minimizes disruption of the work force and maximizes the productive usage of affected personnel. Fixler (1987) reports that Phoenix "begins planning to accommodate employee transfers up to a year and a half before a possible privatization program goes into effect."

SECTION VI

Summary

■ The most common form of privatization on the local level of government is contracting out. Every indication is that contracting out has become an increasingly common management tool for cities and counties. Between 1972 and 1982, the dollar amount of local government contracts with local governments more than tripled. Likewise, the percentage of cities contracting out a wide range of municipal services, ranging from refuse collection to data processing, has risen dramatically since 1973. This upward trend in contracting out appears likely to continue over the next ten to twenty years. By the year 2000 private sector contracts with governments are expected to be as high as $3 trillion, according to an estimate by the accounting firm Touche Ross.

One of the most controversial issues associated with contracting out is: What will happen to the jobs of government employees who formerly performed the service? Government employees have traditionally vigorously protested contracting out because they fear they will become unemployed or they will suffer reductions in wages and benefits if they are forced to work for a private contractor.

This public employee opposition has in the past turned the contracting out alternative into a political hot potato for government officials to handle. In a recent survey of government managers (Touche Ross, 1987) 47 percent of the respondents listed "union or employee resistance" as a major impediment to contracting out services. Unions have proven themselves formidable obstacles to privatization in the past, through such methods as winning court injunctions to prevent a jurisdiction from contracting and by engaging in public relations campaigns to turn the citizens against proposed contracts.

The lesson of these incidents is that government managers who wish to contract out services on a broad scale must first satisfactorily address the employment concerns of government workers. In cities with a heavily unionized workforce it is extremely difficult to contract out services if the public employee union is strongly opposed to the concept.

Based upon our exhaustive survey of the literature and our interviews with local officials from seventeen cities and counties that are heavily dependent upon the private sector to deliver services, we have come to the following conclusions on the impact of contracting out on employment:

1) The number of government workers who ultimately lose their jobs because of service contracts is quite small.

■ The most reliable studies on this subject have examined the subsequent job experience of federal workers who were affected by service contracting. Typically, only between 5 percent and 10 percent of the government workforce whose jobs are affected by contracting out are involuntarily separated from the government. The vast majority of workers either are transferred to other government jobs, take a position with the private contractor, or retire.

On the local level, no systematic multi-city study examining the issue of job displacement has been undertaken to our knowledge. We conclude that this is an area where further research is needed.

2) Public assistance payments made to affected government workers are very small relative to the money saved by contracting out.

■ The most comprehensive study of public assistance payments—including welfare benefits and unemployment insurance—made to workers who lost their jobs due to service contracting was conducted by the U.S. General Accounting Office (1985). Based upon surveys of 94 workers who had become unemployed as a result of contracting out, total public assistance payments were estimated to

equal only 0.4 percent of the cost savings from competitive contracting. These public assistance payments were so small relative to contract savings that in most cases they would in no way alter the government's decision to contract out.

3) The wages paid by private contractors are somewhat lower than those paid by the government, with the wage disparity varying widely among services.

■ Although the typical private vendor's total labor costs are significantly lower than that of the "in-house" government agency, this is not mainly attributable to the private firm paying lower wages. Though the evidence on this issue is mixed, most studies have concluded that private contractors wages are only slightly lower than public sector wages. Based on data compiled by the U.S. General Accounting Office, we calculated, for instance, that former federal employees who went to work for a private contractor suffered an average salary reduction of about $650.

The most comprehensive study of wages paid by firms contracting with local governments (Stevens, 1984) rejected the notion that private contractors cut costs by slashing worker pay. Looking at eight services routinely contracted by local governments, the author concluded that while wage differences do emerge for certain services, salaries paid by the private vendor and the municipal agency were roughly the same. Other studies, however, have found that for some activities, such as transit services, private firms pay their workers substantially less than the government pays its public operators.

4) Private contractors normally offer substantially lower fringe benefits to their workers than does the government to its workforce.

■ One of the major ways that the contractor saves on total labor costs is by offering its workers significantly less generous fringe benefits than the government offers. We found evidence that for all levels of government the public sector offers more attractive retirement benefits, sick leave, vacation, health coverage, and life insurance. For some services examined in the literature, the overall dollar value of the fringe benefit package was found to be over twice as high in government than with a private vendor.

Lower worker fringe benefits appears to be an important source of savings for the private firm when competing against the government for service contracts.

5) Contracting out is not inherently harmful to minorities or women.

■ In percentage terms, minorities and women are more likely to be affected by service contracts than white men, but this is solely attributable to the fact that women and minorities constitute a disproportionate share of the public workforce relative to their participation in the overall labor market. A study by the Joint Center for Political Studies found that jobs made available by private contractors were filled by blacks in the same percentage that these jobs were filled by blacks in the government agencies. Blacks were harmed by contracting only to the extent that private contractors offered lower pay than did their government employer.

The literature on the impact of contracting on women is somewhat limited. We looked at the occupations that women generally fill in government and found that a very large percentage are in white collar jobs. To the extent that white collar jobs are less likely to be candidates for contracting out than blue collar jobs, women may be less adversely affected by contracting out than are men.

6) When secondary labor market effects are fully accounted for, contracting out may have a slightly positive impact on the overall number of jobs available in the economy.

■ Economic theory suggests that the cost savings from contracting out will be used to create jobs elsewhere in the economy. The secondary labor market effect could be substantial, depending upon the amount of cost savings and how the government filters these savings back into the economy.

Unfortunately, we were able to uncover only one study that examined these secondary labor market effects. This study (Charles Rivers Associates,

1986) examined transit contracting. It found that if the municipalities contracting out transit operations used the 20 percent to 30 percent savings that typically arise from competitive contracting to provide additional transit services, then overall employment in this industry would **rise** by between 1 percent and 6 percent of the number of affected positions. If all of the savings were passed back to the taxpayers, the number of jobs lost in the transit field would just about equal the number of jobs created in other industries.

Interviews With Local Officials

■ Our interviews with local officials from seventeen cities and counties generally confirmed these conclusions. We interviewed city managers, budget officers, and directors of personnel. Our conclusions based upon these interviews are as follows:

Detailed Statistics Lacking

■ In general these cities have not kept detailed statistics on the subsequent labor market experience of government workers affected by service contracts. However, various departments in some of the cities were able to supply rough data on the number and percentage of lay-offs brought about because of a service contract. We were able to obtain from these seventeen cities and counties estimates of lay-offs for 22 service contracts that had affected at least 10 workers.

Worker Lay-offs Rare

■ Our finding is that lay-offs resulting from these contracts were extremely rare. In the majority of cases **all** of the government employees were either transferred to another government agency, placed in a job with the private vendor, or took early retirement. In only a few of these 22 cases for which we found data were more than 10 percent of the affected workers laid off.

Few Cities Have Formal Employment Policies

■ Only 3 of the seventeen cities and counties surveyed had developed formal employment policies for contracting out services. These were Los Angeles County, Phoenix, Arizona, and Newark, New Jersey. Officials from all of the other cities indicated that they establish contracting out employment policy on an ad hoc basis. Many of the local officials expressed a reluctance to establishing an employment policy to cover all new contracts out of fear that this would build an undesirable degree of rigidity into the contracting process.

Additional Research Needed

■ We feel that by conducting additional interviews with government officials, private vendors, union officials, and affected workers it would be possible to construct a more complete picture of the employment consequences of contracting out. A more thorough investigation of the employment treatment strategies would also provide a reliable guide for government officials attempting to deal with the principal obstacle to contracting out at all levels of government: worker resistance.

SECTION VII

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